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On the cover, Bill Balhoff with his grandsons, Owen Ferguson (left) and Hayes Leitner, and above: Photos by Stacy Revere/AP Images

ARTICLES

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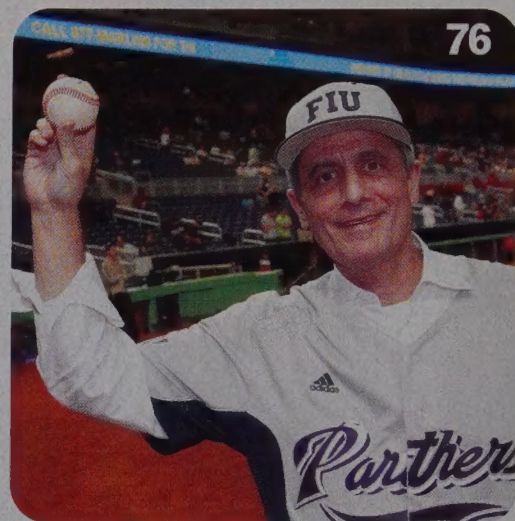

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Publisher
Joanne E. Fiore (jfiore@aicpa.org)

Executive Editor
Kim Nilsen (knilsen@aicpa.org)

Managing Editor
Rocky S. Rosen (rrosen@aicpa.org)

Editor-in-Chief, Tax
Alistair M. Nevius (anevius@aicpa.org)

Assistant Managing Editor
Jeffrey Gilman (jgilman@aicpa.org)

Tax Technical Content Manager
James A. Beavers (jbeavers@aicpa.org)

Editorial Director
Jack Hagel (jhagel@aicpa.org)

Senior Editors
Neil Amato (namato@aicpa.org)
Chris Baysden (cbaysden@aicpa.org)
Paul Bonner (pbonner@aicpa.org)
Jeff Drew (jdrew@aicpa.org)
Megan Pinkston (mpinkston@aicpa.org)
Sally P. Schreiber (sschreiber@aicpa.org)
Ken Tysiac (ktysiac@aicpa.org)
Sabine Vollmer (svollmer@aicpa.org)

Senior Assistant Editor
Amelia Rasmus (arasmus@aicpa.org)

Copy Editors
Todd Conard (tconard@aicpa.org)
Pamela Nelson (pnelson@aicpa.org)

Contributing Editor
J. Carlton Collins
(carlton@asaresearch.com)

Art Director
Michael Schad Johnstone
(mjohnstone@aicpa.org)

Administrative Assistant
Christine Sposito (csposito@aicpa.org)

Associate Publisher
Karin DeMarco (kdemarco@aicpa.org)

Senior Manager, Business Development
Shreyas Mecheri (smecheri@aicpa.org)

Advertising Representatives
Joanne Bailey (jbailey@aicpa.org)
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Contributing AUTHORS

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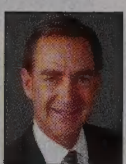
Neil Amato is a *JofA* senior editor covering management accounting and corporate finance. He has 18 years of journalism experience at daily newspapers in North Carolina.

■ **How to Value a CPA Firm for Sale** page 30

Joel Sinkin is president of Transition Advisors LLC in New York City. The firm exclusively consults on ownership transition for public accounting firms, providing advice on succession planning, mergers and acquisitions, and partnership agreement issues. He has been involved with and consulted on hundreds of successful closings of accounting firm mergers and acquisitions over the past 20 years, has taught CPE courses for state and national accounting associations around the country, and has published books and articles nationally. He also is an editorial adviser to the AICPA newsletter *Small Firm Solutions*.



Terrence Putney, CPA, is CEO of Transition Advisors LLC. In that role, he has been involved with and consulted on hundreds of accounting firm mergers and acquisitions and also has consulted on succession planning strategies for partners of firms. He has more than 30 years of experience in the CPA profession, including as a managing director of mergers and acquisitions for one of the largest national accounting firms and managing partner of a midsize Midwest CPA firm.

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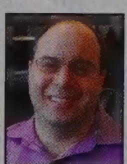

Chris Baysden is a *JofA* senior editor. He oversees coverage of business valuation and personal financial planning. He has more than 15 years of journalism experience, including more than a decade in various reporting and editorial capacities with American City Business Journals.

■ **When the Rules and the Law No Longer Agree** page 38

Ahava Goldman, CPA, is a senior technical manager with the AICPA Audit and Attest Standards Team. She serves as staff liaison for the Auditing Standards Board, supporting the board's standard-setting activities. As a technical manager, she also helps develop nonauthoritative professional guidance. Previously, she served as a senior manager on the AICPA Examinations Team. Before joining the AICPA, she was a supervisor at DDK & Co., a manager at Ernst & Young LLP, and a senior accountant at Kipnis & Karchmer.

Thomas A. Ratcliffe, CPA, CGMA, Ph.D., is senior accounting and auditing technical director for Warren Averett LLC, and director emeritus at the school of accountancy at Troy University in Alabama. He is a former chair of the Accounting and Review Services Committee and served as a member of the Auditing Standards Board. He served as a founding member of FASB's former Private Company Financial Reporting Committee and was a member of the task force that developed the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities.

■ **Before You Sign: Natural Gas Lease Tax Issues** page 44

Sally P. Schreiber, J.D., is a *JofA* senior editor specializing in tax. She was a tax associate with a large law firm in Philadelphia for more than 10 years and an editor at RIA for 13 years.

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Laura Jean Kreissl, Ph.D., is an assistant professor of accounting at West Texas A&M University in Canyon, Texas, where she has taught cost and managerial accounting and accounting ethics courses. She has written for numerous publications, including a number of articles for the *JofA*.

Darlene Pulliam, CPA, Ph.D., is Regents Professor and McCray Professor of Accounting in the College of Business at West Texas A&M University in Canyon, Texas, where she teaches tax accounting and CPA exam preparation courses. She has written for numerous publications, including a number of articles for the *JofA* and *The Tax Adviser*.

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HIGHLIGHTS

The converged proposal on financial reporting for leases faced resistance as the comment period closed Sept. 13.

FASB's Investor Advisory Committee (IAC) declined to support the proposal, stating that the proposal is not an improvement to current accounting. And the Equipment Leasing and Finance Association (ELFA), a U.S. trade group, continued its campaign against the proposal with a news release drawing attention to the advisory committee's dissent.

"This raises another key question," ELFA President and CEO William Sutton said in a news release seizing upon the IAC's conclusion. "Is the cost/benefit analysis in the exposure draft sound if key users and other stakeholders maintain that current GAAP gives them better information than the proposed exposure draft and that the proposed rules are too complex?"

The proposal by FASB and the International Accounting Standards Board (IASB), available at tinyurl.com/ldedjoo, calls for lessees to report a straight-line lease expense in their income statement for most real estate leases. In most equipment and vehicle leases, lessees would recognize leases as a nonfinancial asset measured at cost, less amortization. This would result in a total lease expense that generally would decrease over the lease term.

Former FASB Chairman Leslie Seidman said when the proposal was released that it reflects investors' views that leases are liabilities that belong on the balance sheet. IASB Chairman Hans Hoogervorst said in a speech in September in Berlin that bringing leases onto the balance sheet will have benefits for preparers in addition to providing information that currently is obscured from investors.

(Continued on page 13)

AUDITING

The PCAOB is urging auditors of broker-dealers to conduct audits with due professional care and skepticism after PCAOB inspectors identified deficiencies in 57 of the 60 audits of broker-dealers reviewed during the final 10 months of 2012.

A report on the PCAOB's interim inspection program for broker-dealer audits said board inspectors reviewed portions of a total of 60 audits conducted by 43 public accounting firms. The inspections staff found that auditors were involved in the preparation of the financial statements they audited in 22 of the 60 audits examined, contrary to SEC independence rules. The report is available at tinyurl.com/p5cvja2.

These independence findings were identified in about 8% of the audits performed by firms that also audit public companies, but they were found in about 80% of the audits performed by firms that audit brokers and dealers but not public companies.

Deficiencies were most commonly reported with respect to:

- Audit procedures related to net capital and customer reserve supporting schedules, compliance with the conditions of the exemption claimed by the broker or dealer, and the accountant's supplemental report on material inadequacies.
- Audit procedures regarding tests of revenue, related parties, and the consideration of fraud in the audit of the financial statements.

The PCAOB urged firms that audit brokers and dealers to review:

- Arrangements with brokers and dealers, and quality-control procedures, for the purpose of upholding SEC independence rules.
- Guidance and training to determine whether appropriate attention is being given to areas where PCAOB inspectors found deficiencies.
- Policies for supervision and review to help ensure that firm partners and supervisors are paying sufficient attention to these areas.

Broker and dealer management and audit committees—or their equivalent—may want to inquire with their auditors about how audits are addressing these areas, the PCAOB suggested.

The board will continue to conduct inspections of firms that audit brokers and dealers under the interim program until rules for a permanent inspection program take effect. A rule proposal for a permanent inspection program is expected in 2014 at the earliest.

Auditors of brokers and dealers, meanwhile, have a change on the horizon with respect to the standards they follow. Beginning with audits effective for fiscal years ending on or after June 1, 2014, audits of broker and dealers will be conducted in accordance with PCAOB standards. Audits for fiscal years prior to that date have been conducted in accordance with GAAS.

Audit regulators in the United States and the United Kingdom agreed to continue cooperating on cross-border supervision of audit firms, the U.K. Financial Reporting Council (FRC) announced.

The agreement between the FRC and the PCAOB does not contain an expiration date, but follows recent European Commission

decisions that allow such agreements until July 31, 2016.

The agreement allows for joint work on inspections and exchanges of otherwise confidential information.

A data protection agreement signed by both parties describes the limitations on data that can be made available to the PCAOB, and the PCAOB's responsibilities for protecting data received from the U.K.

BUSINESS & INDUSTRY

U.S. companies expect to make more money, and spend more of it, in the year ahead—and that could translate into more jobs. At the same time, finance executives' outlook of the overall economy has cooled.

Those are the key takeaways from the third-quarter AICPA Business & Industry Economic Outlook Survey.

The quarterly survey, available at tinyurl.com/93a9s7n, takes the temperature of more than 1,200 finance professionals across industries, gauging their outlook in nine key areas: U.S. economic optimism, organization optimism, expansion plans, revenue, profits, employment, IT spending, training and development, and other capital spending.

Those nine indicators make up the CPA Outlook Index (CPAOI), which matched a post-recession high of 69 in the most recent survey. That's even with last quarter, when optimism about the U.S. economic outlook and the fortunes of respondents' own companies surged. A score above 50 indicates a positive outlook.

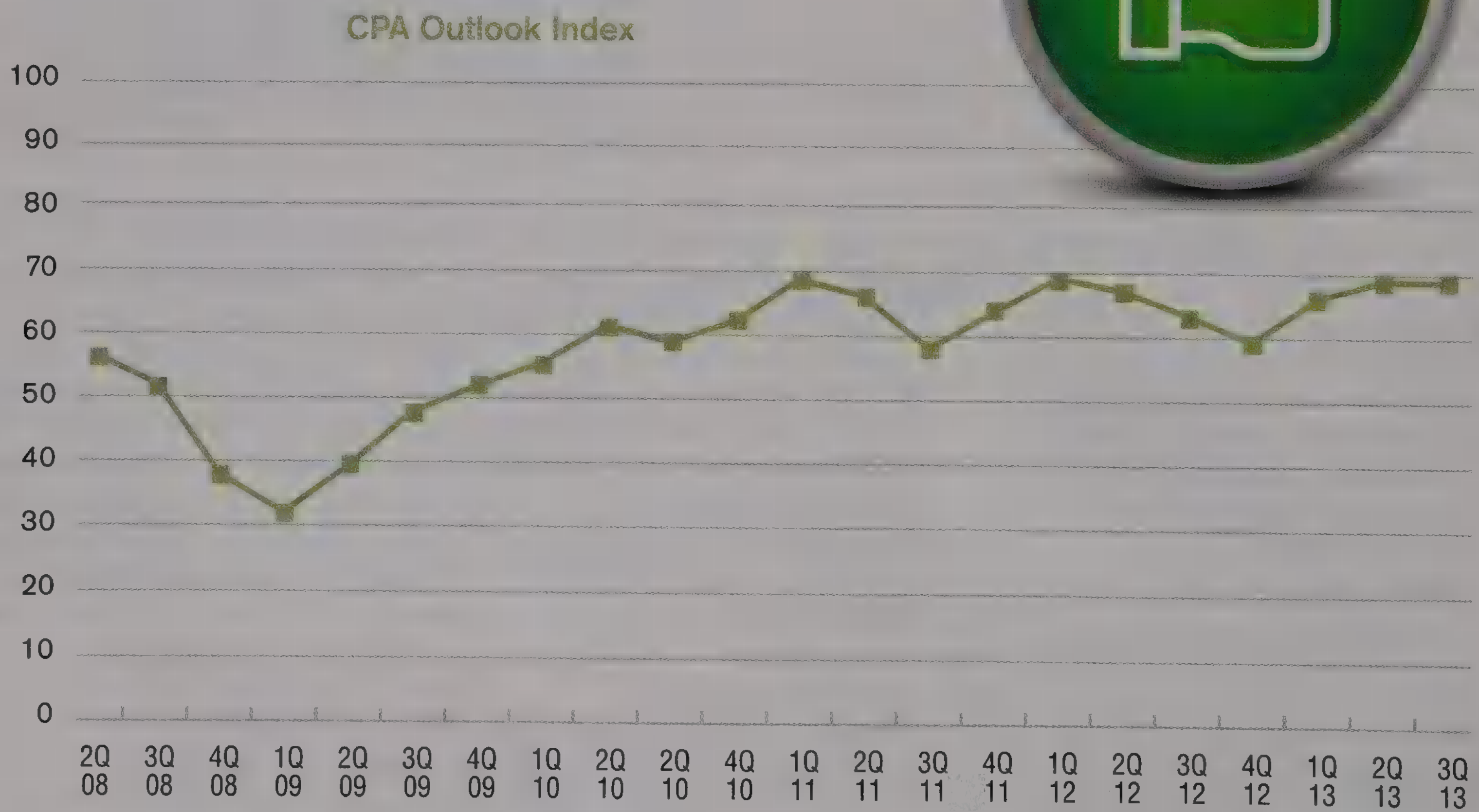
Companies plan to ramp up hiring, according to the survey. About one-third of companies (34%) said they have too few employees. Also, 15% plan to hire, up from 9% a year ago. That's a post-recession high for the survey. Small businesses in particular are more inclined to hire; 20% said in the most recent quarter that they are reluctant to hire, compared with 25% who were reluctant to add staff in the previous quarter.

Overall, companies plan to grow their staffing 1.3% in the next 12 months, compared with 0.8% a year ago.

The most recent CPAOI was propped up by improved attitudes about revenue—and how that money might be spent. The

CPAs Remain Upbeat About Economy

CPAs continue to be optimistic about the U.S. economy, according to the AICPA Business & Industry Economic Outlook Survey for the third quarter of 2013. The CPA Outlook Index, a broad measure of CPA decision-makers' sentiment about the economy, remained at 69 for the second straight quarter, tying a high-water mark that has been equaled three other times in the past three years.



Source: *AICPA Business & Industry Economic Outlook Survey, 3Q 2013*, **tinyurl.com/93a9s7n**.

PHOTO BY ISTOCKPHOTO/THINKSTOCK

outlook for revenue hit its highest point since the first quarter of 2012. Meanwhile, optimism surrounding expansion plans and other capital spending—and profits—climbed to their highest levels in the past year. The outlook for IT spending also remained strong.

The outlook in those categories was tempered by optimism about the overall U.S. economy, which dipped from 66 to 62—the biggest quarter-to-quarter drop of any of the nine indicators. Organization optimism also dipped by a point compared with the previous quarter, as did the outlook for training and development expenditures. Those declines, driven in part by concerns about health care reform and political gridlock, kept the index from eclipsing 70 points—a mark last achieved in 2007.

The short-term story obscures the tale of an otherwise upbeat year. On a year-over-year basis, sentiment improved in all nine sectors of the index, including a 21-point increase in U.S. economic optimism and a seven-point gain in company optimism.

HIGHLIGHTS

(Continued from page 11)

"For many companies, such as airline and railway companies, the off-balance-sheet financing numbers can be quite substantial," Hoogervorst said. "It has been estimated that the hidden leverage in leases leads to an underestimation of long-term debt by some 20%. So we are not talking about small fry."

During the IAC's meeting with FASB on Aug. 27, IAC member David Trainer, CEO of investor research company New Constructs, said it's helpful to get more transparency on the liabilities related to leases. But he said the complexities of leasing activity make it almost impossible to create a one-size-fits-all solution that can be put on the balance sheet.

The IAC recommended that the boards increase disclosure requirements about leases rather than placing them on the balance sheet.

"Having to unwind an accounting construct put on the balance sheet and then having to do my own analysis is not very desirable," Trainer said. "I'd rather just have the data there and let me do with it what I think I ought to do with it."

The boards hope to have a converged standard in place by 2014, with implementation expected to start not earlier than fiscal years beginning on or after Jan. 1, 2017.

FINANCIAL REPORTING

■ Russell Golden used his first major speech as FASB's chairman to describe plans to increase the efficiency and effectiveness of the board's operations.

Golden provided wide-ranging remarks about FASB's future as he spoke at a one-day conference in New York City celebrating the board's 40th anniversary.

He said the board needs to evaluate its agenda decision process, improve its Accounting Standards Codification (ASC), and attempt to shorten the duration of its projects while enhancing the projects' quality.

Golden said FASB will analyze areas where the ASC may be improved. The board will determine whether it can improve how it writes and communicates changes to the codification.

Some of the more confusing sections will be rewritten, Golden said. The board currently is rewriting the ASC's liabilities and equity section.

"We should listen to our stakeholders across the country who have delivered mixed reviews regarding the codification," Golden said. "Most agree and applaud the concept of the value of the codification, but they also observe that, as presently constituted, it is very cumbersome and not user-friendly."

FASB also plans to:

- Continue improving the way it communicates with stakeholders. Focusing on nontechnical audiences and "plain English" explanations is a key objective.
- Reduce the complexity and cost of applying standards. The work of the Private Company Council (PCC) plays a role in that, but simplicity is sought for both private and public companies.
- Increase its cooperation with its parent organization—the Financial Accounting Foundation (FAF)—and GASB, which also falls under FAF's umbrella.

In addition, Golden said, FASB plans to continue pursuing convergence with the International Accounting Standards Board (IASB) while also carrying out its mission of improving U.S. capital markets. He said this can be accomplished by:

1. Completing the remaining major convergence projects on revenue recognition, leases, financial instruments, and insurance.
2. Considering IFRS and convergence while making changes to U.S. GAAP.
3. Actively participating in the development of IFRS.
4. Enhancing relationships and communications with other national standard setters.

■ A new tool developed by the AICPA provides guidelines to help privately held businesses determine which accounting framework best meets their financial reporting needs.

The AICPA in June released the new Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs, available at tinyurl.com/bql5o8e), for use by private, owner-managed businesses when GAAP financial statements are not required.

Meanwhile, FASB and the PCC are developing potential alternatives for private companies within GAAP. Four narrowly scoped alternatives for private companies have been proposed by FASB and are under consideration by the PCC and FASB.

The AICPA developed its decision-making tool with input from the National

Association of State Boards of Accountancy. The tool, presented as a nonauthoritative aid whose use is not required, takes readers through a step-by-step process for choosing a framework.

The tool, available at tinyurl.com/pyjmkzv, immediately advises use of GAAP financial statements for entities that:

- Face a reporting requirement that demands GAAP-based financial statements; or
- Operate in an industry that uses transactions requiring highly specialized accounting guidance that makes use of a non-GAAP framework insufficient for financial reporting.

For the remainder of privately held entities, the tool presents considerations to help decide whether GAAP, the FRF for SMEs, cash/modified cash basis, or tax basis is the most suitable accounting framework. Organizations also are advised to consult with their CPA firm and external stakeholders, where appropriate.

Before issuing the tool, the AICPA released illustrative financial statements and disclosures (available at tinyurl.com/n9xvsd8) as an aid to implementing the FRF for SMEs that help distinguish between financial statements based on the new framework and GAAP-prepared statements.

■ FASB formally issued for public comment a proposal that would exempt many private companies from the requirement to apply variable-interest entity (VIE) consolidation guidance to lessor companies under common control.

The proposal, which was originally advanced by the PCC, would create an alternative within U.S. GAAP that would address a common source of frustration for private companies and their financial statement preparers.

Under the proposal, *Applying Variable Interest Entity Guidance to Common Control Leasing Arrangements* (formerly FIN 46(R) and FASB Statement No. 167), a private company lessee would have the option not to apply VIE consolidation guidance when:

- The lessor and the private company are under common control;
- The private company has a leasing arrangement with the lessor; and
- Substantially all activity between the two companies is related to the lessor's leasing activity.

The proposal is available at tinyurl.com/ozm89xn.

Additional disclosures would be required of private companies that apply this exemption. These disclosures would include:

- The key terms of the leasing arrangements.
- The amount of debt and/or significant liabilities of the lessor under common control.
- The key terms of existing debt agreements of the lessor under common control.
- The key terms of any other explicit interest related to the lessor under common control.

The comment period ended Oct. 14. The effective date would be determined after the PCC considers feedback received on the exposure draft.

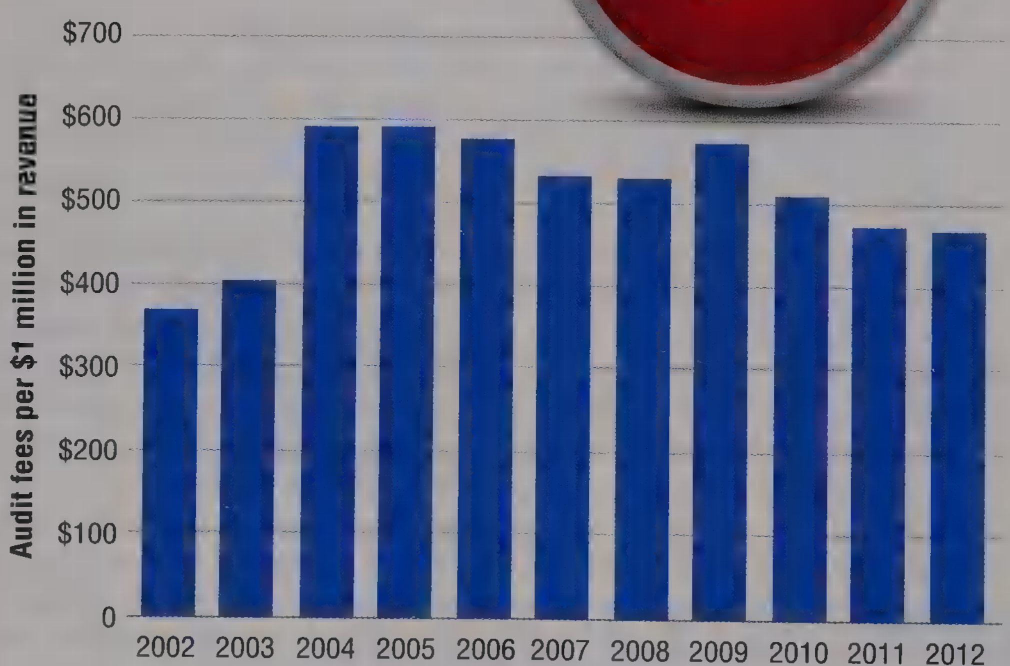
After reviewing feedback, the PCC will have an opportunity to make changes and hold a vote that would forward the final version of the GAAP exception to FASB. If FASB endorses the exception, the alternative would be written into GAAP.

Companies that can use the exception would continue to apply other applicable FASB guidance, including Topic 840, *Leases*, and Topic 460, *Guarantees*.

■ FASB voted to propose changes designed to improve the relevance and reduce the complexity of development-stage entity financial reporting.

Ratio of Audit Fees to Revenue Declining

The ratio of audit fees paid by a sample of 2,408 SEC accelerated filers over revenue in 2012 was the lowest since 2004, after which Section 404 of the Sarbanes-Oxley Act of 2002 was implemented, according to Audit Analytics research. The ratio declined for the third consecutive year.



Source: Audit Analytics report, *Audit Fees and Non-Audit Fees: An Eleven Year Trend*.

PHOTO BY ISTOCKPHOTO/THINKSTOCK

The board planned to issue an exposure draft by the end of October that would apply to public and private entities.

During a July 16 meeting, the PCC recommended that FASB add a project to its technical agenda that would help decrease the complexity of financial reporting for all organizations that are in the development stage.

According to FASB, a development-stage entity devotes substantially all its efforts to establishing a new business and:

- Has not begun planned principal operations; or
- Has begun planned principal operations without producing significant revenue.

U.S. GAAP requires development-stage entities to present the same basic financial statements and apply the same recognition and measurement requirements as established operating organizations for revenues, startup costs, and other similar costs.

Development-stage entities also are required by U.S. GAAP to present inception-to-date information about income statement line items, cash flows, and equity transactions. The cost and lack of relevance of these additional presentation requirements has led to concerns among stakeholders.

■ Accounting standards for risk financing and insurance-related activities of state and local governments, including public risk pools, achieve their purpose, according to a Financial Accounting Foundation (FAF) review report.

GASB Statements No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, and No. 30, *Risk Financing Omnibus*, were reviewed by a FAF post-implementation review (PIR) team. The full report is available at tinyurl.com/ov4rnha.

In addition, the PIR team:

- Is reviewing FASB Statement No. 157, *Fair Value Measurements*. The review will include a survey of stakeholders about the application and effectiveness of the standard.
- Will start a review of FASB Statement No. 123(R), *Share-Based Payment*, later this year.

Parties who would like the opportunity to participate in PIR surveys can register online at tinyurl.com/c467dkj.

■ FAF issued a revised proposal describing a process that would decide which information GASB could consider for its standard setting for state and local governments.

Under the proposal, GASB would consult with the FAF trustees' Standard-Setting Process Oversight Committee to determine whether particular information falls within the scope of GASB's standard-setting mission.

The revised proposal is available at tinyurl.com/nek2ua5. Comments were due Sept. 30.

The revised proposal diminishes the role the FAF trustees would have performed under the original proposal. FAF Chairman Jeffrey Diermeier said in a news release that many stakeholders had expressed concerns that the trustees were stepping into GASB's standard-setting role.

■ FASB released its proposed 2014 U.S. GAAP Financial Reporting Taxonomy.

The taxonomy consists of a list of computer-readable financial reporting labels coded in XBRL. The proposal contains updates for accounting standards and other recommended improvements to the official taxonomy, which is used by public issuers registered with the SEC.

Comments on the proposal, which is available at tinyurl.com/lcqcex3, were due Oct. 31. FASB plans to complete and publish the 2014 U.S. GAAP taxonomy early next year.

Although FAF, FASB's parent organization, maintains the taxonomy, questions about using it to create and submit XBRL-tagged files in compliance with SEC rules should be directed to the SEC.

PERSONAL FINANCIAL PLANNING

■ Many U.S. adults lack a basic understanding of common financial terms found in health insurance plans as they face critical decisions about their future coverage, according to an AICPA survey.

More than half of respondents (51%) polled in July could not accurately identify at least one of the following terms: premium, deductible, and copay, according to a telephone survey of 1,008 U.S. adults by Harris Interactive. These terms are commonly used in health insurance plans.

The Patient Protection and Affordable Care Act, P.L. 111-148, which was passed in 2010, requires individuals to purchase health insurance or pay a penalty beginning in 2014. Although open enrollment was scheduled to begin in October, the survey found that knowledge of the health care law and its implications is limited.

Forty-one percent of respondents said they are not at all knowledgeable about the law, and another 48% said they are somewhat knowledgeable.

"Half of Americans would fail health insurance 101," Ernie Almonte, CPA, chair of the AICPA's National CPA Financial Literacy Commission, said in a news release. "That's critical insight as consumers prepare to make important decisions with implications for both their health and fiscal well-being."

Fourteen percent of those surveyed said they do not have health insurance; half of those respondents said figuring out how to pay for health insurance is their biggest concern about the mandate. The requirement to purchase health insurance is the biggest financial concern for 11% of survey respondents.

Tips on evaluating and choosing health insurance are available at the AICPA's financial education site at 360financialliteracy.org.

DRAFTS OUTSTANDING

■ IFAC

Reporting on Audited Financial Statements: Proposed New and Revised International Standards on Auditing. Comment deadline: Nov. 22. ED available at tinyurl.com/pqnfcfk.

■ PEEC (AICPA)

Proposed Definition of Those Charged With Governance. Comment deadline: Nov. 10. ED available at tinyurl.com/pkb24ga. ❖

Professional Liability SPOTLIGHT

The Pitfalls of Assuming Management Responsibilities

by Sarah Beckett Ference, CPA

Defending professional liability claims is difficult when practitioners assume responsibilities beyond the scope of their engagement. The difficulty in defending against a claim increases dramatically if the CPA undertakes activities considered to be the responsibility of "management" and if the client, based on the CPA's words and actions, believed it could rely on the CPA to perform what was generally understood to be an internal management function. Doing so provides an opportunity for plaintiff counsel to assert that the CPA "should have known better."

So, how easy is it to cross the line from service provider to being perceived as a member of client management? The following hypotheticals, which are based on the claim experience of the AICPA Professional Liability Insurance Program, provide examples:

Scenario 1. For several years, a CPA provided bookkeeping and compilation services to a small but growing construction company. The CPA's engagement letter listed the client's responsibilities, including review of a monthly payment register and preapproval of invoices exceeding a specified threshold. As business grew, the owner had little time available to oversee the CPA's activities and increasingly relied on the CPA's experience with and knowledge of the company's operations. Wanting to help the busy owner, the CPA told the owner that he would "take care of things," stopped sending the register for review, and paid bills as they became due, even if they exceeded the specified threshold. The owner subsequently discovered that his assistant had established several fictitious vendors and created false invoices, which were processed and paid by the CPA. He brought a professional liability claim against the CPA for failing to detect the embezzlement.

Scenario 2. A small not-for-profit organization engaged a CPA firm to provide bookkeeping, compilation, and strategic financial consulting services. The firm's standard engagement letter for write-up and compilation services was used and included a reference to the provision of "other financial consulting services as considered necessary," but it failed to define those services. Because the organization had no internal accounting resources, the board of directors requested that the CPA attend its monthly meetings to advise on the organization's finances. The CPA agreed to attend. At one meeting the board discussed and decided to invest in a real estate parcel. During this discussion, the CPA was distracted by another client matter and checked his email frequently. The real estate subsequently declined significantly in value. The client sued the CPA, alleging he failed to provide advice regarding the investment risks in connection with his attendance and participation in the board meetings and provision of "other financial consulting services."

THE ISSUES

Expectation Gap

An expectation gap may be created when the CPA is perceived by clients to be a member of management who has greater authority than that provided in the engagement letter. A client may assume the CPA is responsible for detecting theft or fraud, regardless of the type of service provided, or that the CPA should advise on all matters of which the CPA has knowledge, even if those matters are not covered by the engagement letter, as demonstrated in the previous scenarios.

Professional liability risk is heightened when third parties are involved. A client may ask the CPA to attend a meeting with a third party, such as a lender, to help explain the components of financial statements compiled by the CPA. This may lead the lender to perceive and expect that the CPA is acting as a de facto CFO or controller, which may create a privity relationship between the CPA and the lender. Such a relationship may permit the lender to bring a claim against the CPA.

Fiduciary Standard of Care

Company management, including its directors and officers, owe the organization the fiduciary duties of care and loyalty—meaning they must act in the best interest of the organization they serve. Case law imposes this duty on the corporate officers and directors. A fiduciary duty is the highest standard of care in the law and imposes certain responsibilities that do not apply to most CPA services. Undertaking activities that are considered responsibilities of client management can create a fiduciary duty to the client.

Professional Liability Insurance Coverage

Practitioners who overstep their bounds should understand the coverage parameters of their current policy. Al Fennel, vice president of Underwriting at Aon Affinity, notes, "Professional liability insurance policies typically limit or exclude coverage for services rendered when the policyholder also performs management duties or assumes management responsibilities on behalf of the client,

PHOTO BY FUSE/THINKSTOCK

regardless of whether a formal title is used to describe these duties or responsibilities." Firms should review the details of their professional liability insurance policy and confer with their insurance agent or broker regarding the application of insurance coverage if questions arise.

RISK CONTROL CONSIDERATIONS

CPAs can avoid the pitfalls associated with assuming a client's management duties by taking the following steps:

- Issuing a clearly written and specific engagement letter that defines the scope of services to be rendered, the responsibilities of the CPA and the client, and any limitations on services.
- Performing professional activities within the scope of services as documented in the engagement letter. If additional services are requested, the CPA should execute a signed engagement letter addendum or another written agreement with the client.
- Documenting oral advice or recommendations in the work papers or in a written communication to the client, noting the client's responsibility for taking action on recommendations made.
- Avoiding including statements in engagement letters, marketing materials, and client communications that imply the firm will undertake activities that are the responsibility of client management.
- Requesting that the client designate an individual (preferably at the executive level) with sufficient time and expertise to oversee all services provided by the CPA firm, to communicate the tasks to be performed, evaluate the adequacy and results of services rendered, and accept responsibility for all decisions made.
- Avoiding referring to himself or herself as a client's "interim" or "outsourced" CFO or controller. CFO and controller are internal titles and roles.
- Not assuming responsibility for making management decisions or performing duties that may be construed as the responsibility of management, such as approving journal entries or strategic business plans.
- If attendance at board meetings is required, being first on the agenda, exiting the meeting when his or her role on the agenda is completed, and ensuring the minutes reflect the subject discussed and the time of exit. Additionally, the CPA should send a follow-up communication to the client detailing the discussion. ❖

Sarah Beckett Ference *(sarah.ference@cna.com) is a risk control consulting director at CNA.*

Continental Casualty Co., one of the CNA insurance companies, is the underwriter of the AICPA Professional Liability Insurance Program. For more information, call Aon Insurance Services, the National Program Administrator for the AICPA Professional Liability Program, at 800-221-3023 or visit cpai.com.

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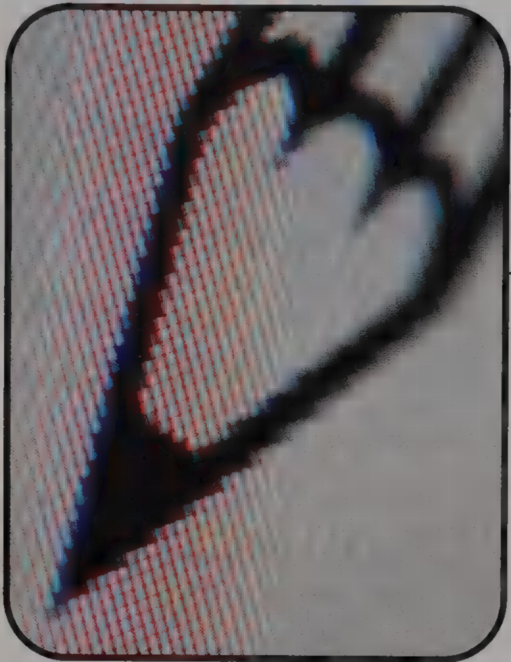

Taking Stock of Leases

In anticipation of a new global standard on financial reporting for leases, Johnson & Johnson created a central repository for thousands of leases it has across hundreds of reporting units in 60 countries. J&J global lease implementation project leader Judy Ryan, CPA, gave tips during a KPMG webcast on how a company can create and use a lease inventory:

✔ ***Get support from senior management.*** The backing of top company executives helps the team creating the inventory get cooperation from numerous business units.

✔ ***Create awareness early.*** Unless staff members are closely following the lease accounting project undertaken by FASB and the International Accounting Standards Board, they may not be aware of the reasons for creating an inventory. Comment letters were due Sept. 13, and the boards have indicated that they hope to have a final standard in place in 2014, with an expected implementation date of not earlier than fiscal years beginning on or after Jan. 1, 2017. The proposed standard, available at tinyurl.com/ldedjoo, would create the need for many new data points that are not included in current lease accounting. The increased complexity has caused some experts to say companies may want to create a global inventory of leases to facilitate smooth financial reporting.

✔ ***Choose a technology solution.*** A new technology platform is likely to be needed to gather the data for the calculations. The tool's ease of use and the level of training needed for users were among the factors J&J considered in selecting its technology platform.

✔ ***Train your staff.*** Employees need to be taught how to use the technology, and it's helpful to explain to them why they are collecting the data.

✔ ***Leverage existing data.*** Creating templates for uploading data that already exist in a company's systems is a lot easier than entering information manually. J&J developed a template and upload process that allowed staff to input large volumes of leases with similar characteristics all at once. This saved the company a significant amount of time.

✔ ***Develop a phased approach.*** The inventory process should start with just a few business units. This will allow troubleshooting any potential problems that occur and improving processes as additional business units are incorporated in future phases.

✔ ***Create customized reports for each business unit.*** Customized reports gave J&J a high-level snapshot of the rental cash flows for each business unit, which helped with some of the other processes involved in building the inventory.

✔ ***Test your data.*** Once the inventory is built, it should be reconciled with records to verify accuracy and completeness.

✔ ***Continue inventory upkeep.*** As leases are added, subtracted, or changed, affiliates in the business units need to enter those changes in the central repository.

✔ ***Find additional value.*** This process is not designed just to make compliance easier. J&J plans to do comparative modeling to see how changing lease terms or discount rates can affect the company's asset liability and P&L statement. Also, the company is trying to understand whether certain assets should be leased, or whether it would be more economical to buy in the future. Having the central repository can help a company evaluate which business decisions would make sense today as well as in the future if and when a new standard takes effect.

*—By **Ken Tysiac** (ktysiac@aicpa.org), a JofA senior editor.*

FROM CGMA MAGAZINE
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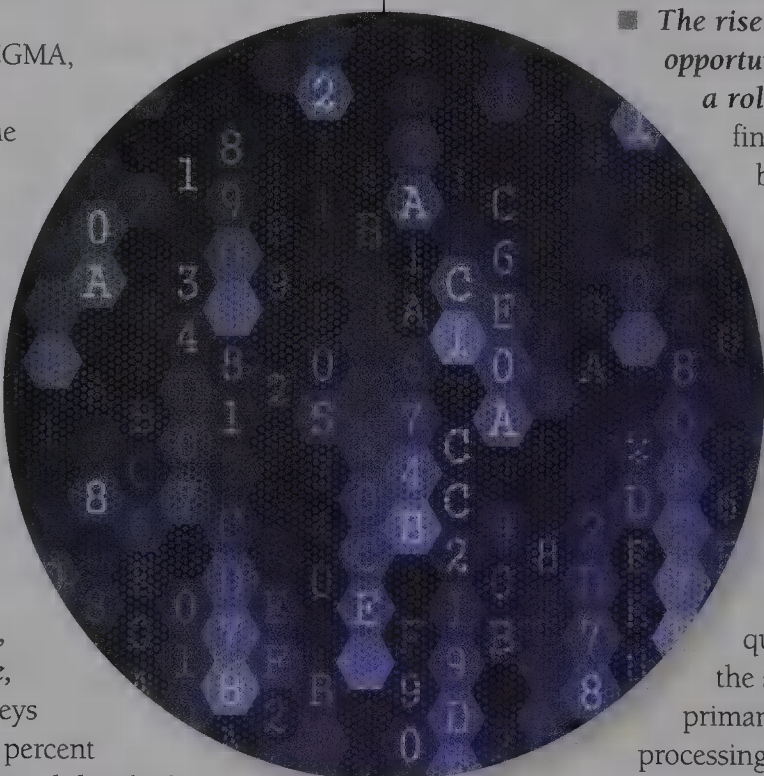
Why Accountants Should Own Big Data

Many organizations recognize the value in harvesting data, whether the information is about customers' buying habits or employees' performance measures. But some companies haven't been able to tap into the full potential of business intelligence—that is, getting the right information from the data to make better business decisions.

Donny Shimamoto, CPA/CITP, CGMA, thinks finance should own the business intelligence role—for the good of accountants and the good of the organization.

Here are three reasons finance should take over business intelligence, according to Shimamoto, founder of IT consulting firm Intraprise TechKnowlogies, who presented at the AICPA Financial Planning & Analysis Conference in Las Vegas in July:



- ***Information is everywhere, but it often lacks relevance, clarity, and accuracy.*** Surveys bear this out. Twenty-eight percent of senior finance executives said they had little or no information to predict the performance of their business in 2013, and another 54% said they had only half the information needed to provide visibility into performance, according to a recent Accenture survey. A recent Gartner report says that businesses are "still struggling to make progress with [business intelligence] and analytics." Accountants can help add clarity to the numbers.
- ***Confidence in information is high when it comes from accountants.*** Satisfaction is lower regarding information supplied by some other departments. "The role of the accountant as a purveyor of truth and as an attester to the quality of the information has become increasingly important," Shimamoto said.
- ***The rise in analytics represents an opportunity for finance to shift toward a role of business partner.*** The finance function has earned trust, but more for the role of watchdog and less for analytical insight. Accountants "can go beyond traditional cost control and start to evolve the role to be looking at the organization as a whole and discussing how to best optimize the performance," Shimamoto said.

Shimamoto breaks down the role of accountants into four quadrants. The most traditional is the steward/controller role, which is primarily for reporting and transaction processing. Then there's the trusted reporter role, which encompasses duties such as Sarbanes-Oxley Act compliance, IFRS, and GAAP.

The third role shifts into more technical expertise. "These are people that are really strong in supporting specific functions," Shimamoto said. "They might have industry expertise or experience in activity-based costing or treasury management."

PHOTO BY ISTOCK/THINKSTOCK

The fourth role is the one to which Shimamoto hopes finance can ascend. "Finance is the key to help unlock the power of business intelligence," he said.

Traditionally, if others didn't speak the language of IT, they were hesitant to learn. That hesitancy is one reason accountants haven't gotten as involved in the application of business intelligence to company decisions.

Accountants today don't need to fret about learning business intelligence thanks to an improvement in BI tools, Shimamoto said. "The tools have evolved to become so user-friendly that you don't need IT to help get the information," he said. "It's evolved now so finance can do it all on [its] own. That's a huge change within the last decade."

If accountants are willing to escape their comfort zone, they can move out of the steward/controller and trusted reporter quadrants and into a more strategic position in their companies, Shimamoto said.

"We're seeing where management accountants are already used to reporting on information on a regular basis," Shimamoto said. "Now as we're looking at overall integrated reporting, reporting on sustainability, reporting on ethics, all are now coming into greater importance and increased focus. So as organizations are capturing data on all these additional topics, that's where the skills that finance has can start to be applied."

The original version of this article, "Three Reasons Finance Should Focus More on Business Intelligence," by Neil Amato, is available at tinyurl.com/prpp3sj.

—Jack Hagel, editorial director
CGMA Magazine

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CGMA Magazine is published in conjunction with the Chartered Global Management Accountant designation, which was created through a partnership between the AICPA and CIMA. The magazine offers news and feature articles focused on elevating and emphasizing management accounting issues.

Also on cgmamagazine.org

International Assignments on the Rise

The number of employees on international assignments is on the rise, and so are the complexity and customization of companies' international assignment programs, a KPMG survey of more than 600 companies from across the world found.

The average number of global assignment locations supported by a multinational company was 22 in 2009, up from 13 in 1998, according to PwC research. By 2020, the average number of global assignment locations is projected to be 33 per multinational.

The full article, "Bring the Whole Family: Rising Demand for Globally Mobile Talent Drives Policy Changes," by Sabine Vollmer, is available at tinyurl.com/nwet6a6.

Companies Gear Up for HR Changes

More than one-third (36%) of 1,025 organizations from 32 countries surveyed by the global professional services firm Towers Watson said they are considering changes to their HR structures in the next 18 months. The impetus for change is the development of new delivery models that can improve efficiency, service to employees, and performance, according to the report.

Nearly three-fourths (74%) of the organizations that are planning HR changes by the end of 2014 expect to experience operational efficiencies as a result. Other results sought from HR changes by organizations planning them include quality improvements (53%) and cost savings (37%).

The full article, "Four Questions to Ask Before Re-Tooling HR," by Ken Tysiac, is available at tinyurl.com/mu5r62s.

Strategic Goals: Some Employees Just Don't Get It

Managers need to be diligent in sharing a company's strategic vision with employees so that those workers stay motivated and have a clear understanding of why they're coming to work every day. That's the recommendation from a recent Robert Half survey that shows a lack of clarity regarding companies' strategy.

Thirty-four percent of CFOs say their employees are not aware or not very aware of the company's strategic business goals. The survey of more than 2,100 CFOs from large U.S. cities shows that smaller companies are less likely to clearly communicate strategic goals to workers.

Just 9% of CFOs at companies of more than 1,000 employees thought workers lacked awareness of company strategy. That's compared with 35% who thought that at companies of 20 to 49 workers.

The full article, "Some CFOs Say Employees Don't Understand Company's Strategic Goals," by Neil Amato, is available at tinyurl.com/omqgq5y.

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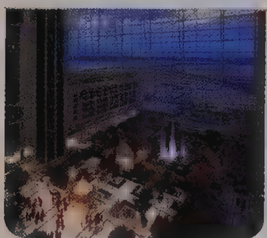

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Considered the benchmark conference for those in the construction industry, the 2013 AICPA National Construction Industry Conference brings together preeminent experts to share their insights on the industry's most recent developments in accounting, auditing, taxation, financial operations, marketing, and financial management.

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December 9-11, 2013 | Chicago, IL; New York, NY; San Francisco, CA; Washington D.C.

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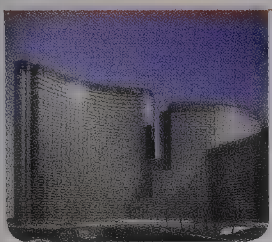
Recommended CPE Credit: 14

It is more important than ever for you to have a firm grasp on the latest regulations and standards for the upcoming audit season. The AICPA Employee Benefit Plans Accounting, Auditing, and Regulatory Update (AARU) is a high-level conference that addresses these critical auditing issues with presentations given by regulators, administrators and industry experts as well as panel discussions, Q&A opportunities and case studies.

AICPA Implementing Personal Financial Planning Services: Step-by-Step Plans for Success



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Recommended CPE Credit: 23

The AICPA Advanced Personal Financial Planning Conference is imperative for financial planning professionals. This conference will provide you with strategies and cutting-edge information and guidance on the following topics: Investment Management, Practice Management, Wealth Management and Eldercare/Retirement.

AICPA/AAML Conference on Divorce

April 24-25, 2014 | Bellagio; Las Vegas, NV

Recommended CPE Credit: 17 (main), 4 (optional workshops)

This biennial conference for financial professionals and lawyers focuses on the latest issues regarding valuation of businesses and marital assets. Most sessions will be presented by both a CPA or financial expert and an attorney, who will present a diverse set of perspectives and insights. As a result, you'll walk away with new solutions to fit your clients' needs, and new methods to achieve proficiency, growth and profitability to your firm.

Several of our conferences offer select sessions via the virtual conference option.

Look for the virtual icon for those conferences that offer this option. If you cannot attend the live conference, this is a great way to keep up-to-date on key sessions you would otherwise miss.

Competitive Advantage

Bill Balhoff brings a family approach to his term as the AICPA's 101st chairman.

by Neil Amato

When reflecting on his life and career, Bill Balhoff can see the tremendous impact his parents' guidance and work ethic has had. He comes from a big family—nine boys and two girls—all with a healthy drive for success.

Balhoff feels fortunate to have been surrounded by supportive family members who take pride in each other's success. Throughout his career, he has also come to realize that a sense of family goes beyond the bonds formed with siblings. When people share in traditions and similar values—whether at home or at work—they build a sense of family.

Balhoff, CPA/CFF, CGMA, views the accounting profession as a large group of high achievers with strong values. He believes that with continued collaboration and consistent, high-quality work, the profession can take the necessary steps to remain relevant in a business environment characterized by complexity and digital-fast change.

In October, he became the 101st chairman of the AICPA, launching his term with a speech focused on quality as a hallmark of the profession.

A Foundation of Quality

Balhoff's focus on quality goes back to the beginning of his career at Postlethwaite & Netterville (P&N), where he began as a staff accountant in 1976 after graduating from Louisiana State University. As the firm's current managing director, he leads according to the same principles stressed by firm founder Alex Postlethwaite all those years ago: *Start with quality service for the client. Everything else follows.*

Postlethwaite's unwavering emphasis on quality service led firm leadership to formally define its core values in 2011. The values form the acronym QUALITY—Q: Quality. U: United with the community. A: Accountability. L: Lifelong learning. I: Innovation and integrity. T: Teamwork. Y: Your co-workers.

Although these values are specific to P&N, Balhoff believes that many of them are relevant to the broader CPA profession. During his one-year term as AICPA chairman, he will focus on quality, leadership, mentoring, and growth.

Shared Values

Strong values were inherent in Balhoff's upbringing. His parents, John and Catherine Balhoff, provided a solid foundation of faith, a clear set of values, and an appreciation for family and tradition.

"My parents had a strong influence on us and a very deep faith. Church and family were at the center of our lives," he said. Five siblings following John Balhoff into chemical engineering shows the great respect they had for their father, Bill Balhoff said. Bill, sixth in birth order, is one of three CPAs.

At home, there was always someone to play a game with, either on the nearby baseball field or the dirt pad and basketball goal in their yard. Growing up with so many brothers and sisters, Balhoff learned to appreciate others' perspectives and to work in teams. He also honed his debate skills.

"A lot of what we do as accounting professionals is negotiation and problem-solving. We have to help our clients understand what is right for them," he said. "Growing up, I had to learn to develop those communication skills, because we debated a lot. And to win, we had to be very persuasive."

Balhoff lived at home during college, working at a furniture store and taking an interest in an LSU student named Sandra Guidry. He also took an interest in accounting. Although he was good at math, that wasn't what drew him.

"Accounting isn't exactly a math field. It is more about problem-solving and working with others," he said. "I liked problem-solving, and I liked working with people."

Instilling Leadership

That passion for working with people has stayed with Balhoff throughout his career, which has been heavily affected by various leadership roles he has held at the firm and in the profession.

Balhoff said he wouldn't have gained the leadership experience he has without a push from several mentors, including the firm's Alex Postlethwaite and Jake Netterville. "They encouraged me not only to provide the highest quality of service, but to also get involved in the profession," Balhoff said. This involvement provided him with a different perspective and a wider network.

Bill Balhoff enjoys visiting his alma mater, Louisiana State University, in Baton Rouge to speak with accounting students.

PHOTO BY CHERYL GERBER/AP IMAGES

Bill Balhoff, CPA/CFF, CGMA
Title: Managing director and CEO, Postlethwaite & Netterville
City: Baton Rouge, La.
Education: B.S. in accounting, Louisiana State University
Date of birth: April 26, 1954
Family: Wife, Sandra; daughters, Bridget Leitner, Stephanie Ferguson, and Gretchen Balhoff; sons-in-law, Beau Leitner and Jeff Ferguson; grandsons, Hayes Leitner and Owen Ferguson
Must-have device: iPad
Good read: *Inferno* by Dan Brown
Caf or decaf: Decaf. "I don't drink coffee. I don't do caffeine."
Favorite food: Any dessert

PHOTO BY STACY REVERE/AP IMAGES

Balhoff admires Netterville, who was the AICPA's chairman from 1992 to 1993, for his "passion for giving back to the community and the profession."

"I don't believe I would be CEO of our firm had I not been involved in the AICPA and the Louisiana Society of CPAs. You work among different types of leaders in the profession, and you're able to see how other people practice outside the four walls of your own building, which to me is very important."

Balhoff believes that looking across the profession for ideas and best practices has made P&N a much stronger firm. "The services we provide, the way we provide those services—our focus on quality is much more defined because of our interaction with leaders throughout the profession," he said.

AICPA President and CEO Barry Melancon, CPA, CGMA, said he looks forward to Balhoff's leadership.

"His relentless focus on the profession's core values and his understanding of smaller firm issues give him a broad view of the opportunities and challenges facing the profession," Melancon said. "In addition, he is fully committed to our added support for the business and industry segment and the CGMA designation. Bill will take our profession on an exciting journey that positions our profession for future growth."

Responsibility and Rewards of Mentoring

Helping position the profession for future growth is something Balhoff takes personally. While the Balhoff engineers still outnumber the Balhoff CPAs, it's safe to say the accounting gene has been passed down. Two of Balhoff's three daughters are accountants, one a CPA and the other studying for the CPA exam. And many nieces and nephews, including the daughter of P&N director George Balhoff, CPA/CITP, also went into accounting. He even has high hopes that his two young grandsons—Owen and Hayes—will become CPAs one day.

> "Technical knowledge is critical in the profession ... but developing leaders is just as critical to our future and the futures of our clients."—Bill Balhoff

Having young family members in the profession also provides him with candid feedback that helps him better understand the challenges being faced by young CPAs. He believes that the leaders of today have a responsibility to mentor the next generation of CPAs.

In his acceptance speech last month, Balhoff announced the AICPA's creation of a resource center specifically to help Private Companies Practice Section (PCPS) members address issues in auditing and accounting, doing so in easy-to-understand language.

This is important to him because he believes knowledge and inspiration should be shared across the profession—not just within CPA firms and businesses. And this has been his experience. In addition to the mentors Balhoff had within P&N, he enjoyed working with mentors outside of his firm. One who was particularly influential was Mason Andres, a CPA he met while performing a peer review of a Texas firm.

"Mason urged me to get involved," Balhoff said. "He felt like I could add something, but he also understood how much it would benefit me. I'll always be indebted to Mason for the confidence he had in me."

Balhoff does his best to instill that same confidence in those he mentors. He passes on the knowledge that was impressed upon him: The more you give, the more you get. He also encourages them to regularly push beyond their comfort zones so that they are constantly growing. He regularly interacts with accounting students at Louisiana universities, including his alma mater LSU, and he's passionate when talking about the flexibility CPAs have to chart their own course in the profession.

Vision of Growth

Balhoff acknowledges it's that flexibility that also presents challenges, as clients become more complex and demand more knowledge and expertise. After all, client needs are different now from what they were in 1976, when Balhoff went to work at Postlethwaite, Netterville, Evans and Major. At the time, it was a firm of 22 accountants in Baton Rouge. Today, P&N is a major firm with about 600 employees.

Being responsive to clients' changing needs is among the reasons the firm has been so successful. "When I started, we did audit, tax, and bookkeeping work," he said. "That is certainly not the case today."

A similar evolution is evident in Balhoff's own career. Although he has worked at one firm his entire career, he feels as though he's been able to reinvent himself through outside service and a variety of P&N roles. He has worked in technical audit and consulting, moving up to partner in 1986 and into his current role in 2008. He has extensive experience in peer review and PCPS issues. He testified before a Senate committee in 2002 on behalf of PCPS members, speaking about the trickle-down effect that legislation, in the wake of the Enron scandal, would have on small and midsize firms.

Balhoff served previously as chairman of the PCPS Executive Committee, and his firm has been a PCPS member since the section's inception. He is also a past member of the Financial Accounting Standards Advisory Council and has experience across a broad range of industries.

Balhoff believes the Institute should continue to focus on increasing diversity and inclusion, encouraging young CPAs to serve on volunteer committees, advancing the dialogue on audit enhancements, and promoting an entrepreneurial spirit.

"Technical knowledge is critical in the profession, especially as it relates to ever-changing regulations," he said. "But developing leaders is just as critical to our future and the futures of our clients."

"As CPAs, we're very good technicians," he said. "But I believe that we need to continue to develop our skill sets as leaders and as critical decision-makers. Our challenge is to keep developing those skills in ourselves and in the people around us."

That's why Balhoff enjoys talking to college students and new hires at his firm. He likes the questions he hears from the next generation of the accounting family. He hears excitement in their voices, the same sort of excitement he felt more than three decades ago when he joined P&N.

"As a CPA, your potential is limitless. You can go anywhere and do anything because you have a widely transferable and adaptable skill set," he said. "But at the end of the day, no matter where you take your career, it should be fueled by passion. My passion is to help others reach their goals, through both innovation and a focus on quality. It's how the profession—and all of our professionals—are going to continue to grow." ❖

Neil Amato is a JofA senior editor. To comment on this article or to suggest an idea for another article, contact him at namato@aicpa.org or 919-402-2187.

The Year Ahead

During Bill Balhoff's term as chairman, the AICPA will work to advance a number of key initiatives, including:

- ***Resource center for PCPS members.*** Balhoff has envisioned the Institute as a "national office" for sole practitioners and other smaller firms. If they have questions, the resource center can supply answers on emerging accounting and auditing issues.
- ***Private company financial reporting.*** The Institute this year issued the Financial Reporting Framework for Small- and Medium-Sized Entities. The framework is for use by private, owner-managed businesses when GAAP financial statements are not required. Meanwhile FASB and the Private Company Council (PCC) are developing potential alternatives for private companies within GAAP.
- ***Audit quality.*** Supporting the work of the AICPA's audit quality centers and the Center for Audit Quality, including the efforts to enhance auditors' professional skepticism, objectivity, and independence.
- ***Not-for-profit.*** Exploration of a resource center for CPAs in the not-for-profit sector.
- ***Peer review.*** Seeking feedback for the creation of "next-generation" peer review practices, in collaboration with state CPA societies. "Peer review has to keep up with the times," Balhoff said.
- ***CGMA.*** Building on the growth of the Chartered Global Management Accountant designation, the joint venture with the Chartered Institute of Management Accountants, and preparing for testing to be part of the process to obtain the designation starting in 2015.
- ***Education.*** Collaboration with other stakeholders to continue developing an Advanced Placement high school course in accounting, which was among the recommendations of the Pathways Commission.

How to Value a CPA Firm for Sale

Fifth in a series: Methods and results differ for external transactions and internal transfers.

by Joel Sinkin and Terrence Putney, CPA

> ### About the Series
> Powerful forces are transforming the accounting profession in the United States. The Baby Boomers are heading into their retirement years. Baby Boomer CPAs are in charge of most U.S. accounting firms, and most U.S. accounting firms don't have a signed succession agreement or practice-continuation plan in place.
>
> These realities are rewriting the rules for U.S. accounting firms and CPA firm owners. Firms must contend with unprecedented financial, cultural, and marketplace changes. The *JofA* is presenting a succession series designed to help accountants navigate the new landscape of succession and mergers. This month's installment, the fifth in the series, looks at how to value a retiring CPA's ownership stake in an internal succession deal or external sale.

One of the key components of a CPA succession plan is the sale or transfer of the retiring CPA's ownership interest. How is the value of that interest determined? In most circumstances, the value of an owner's interest is different when selling to an external buyer than it is in an internal transaction.

External Sales

The most common question about accounting firm sales the authors are asked when teaching CPE courses is "What is the multiple (of billings)?" The multiple is determined by four main factors:

1. Cash Upfront, If Any

In more than 90% of the 900-plus deals the authors have consulted on in the past 24 years, the down payments have ranged from nothing to 20%. The authors have seen many more deals with no cash down than with 15% to 20%. A typical down payment is 10%. The factors that affect buyers' thinking include:

The time of year. For example, if a selling firm bills 65% of its revenue by May 1 and the closing is May 15, the buyer may have to carry the practice at a net loss or break-even for months, so the amount of the down payment, if any, tends to be less. Obviously, the same practice closing Jan. 1 is likely to get more upfront. As with almost all deals of this type, the buyer's ability to obtain a return on investment quickly usually affects the terms offered.

Treatment of accounts receivable. Most sellers expect to retain their receivables—that is, the money they are owed for work they've already completed, plus work still in progress. This is logical. However, consider that the buyer will have to replace those funds, resulting in negative cash flow upfront from the operations. The situation is exacerbated if the acquired client base is accustomed to paying slowly, meaning that the buyer could have to wait months before seeing revenue come in from the buyer's billings. In those situations, the buyer will have to contribute more capital to meet expenses. This can result in lower down pay-

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ments. On the other hand, the authors have seen buyers willing to make larger down payments for the practice if the seller is willing to lend the accounts receivable to the buyer for a period of time following the sale. The buyer then repays the seller for those accounts receivable once positive cash flow is established.

Bank financing and other factors. Banks have tightened credit, making it more difficult to finance acquisitions. One result has been a trend toward lower upfront payments. If significant investments are required while transitioning the practice, such as for technology upgrades, the buyer may be unwilling to pay a lot upfront.

2. Retention Period

The majority of external accounting firm deals base payments on collections. That is, the buyer pays a specified percentage of the fees it collects for a specified period after the deal closes. If the buyer loses clients and the fees fall during that period, then the seller receives less money. Conversely, if fees increase, the purchase payments do as well. It's an arrangement that seems to fly in the face of most business sales, in which the buyer pays a negotiated price. Many of the accountants the authors have worked with over the years were surprised that accounting firm sale prices were determined by a formula based on collections. These are not "buyer beware" sales; rather, such deals are shared-risk transactions unique to accounting firms because the value of firms lies for the most part in client relationships, not hard assets.

Most external sales have a retention period that adjusts the balance due to the seller based on client retention and fees collected. Some retention periods can be as short as one to two years, but many deals are structured with payments based on a percentage of collections over the entire payout period. Rarely do the authors see one-year retention periods. Instead, the recent economic difficulties have led to longer retention periods, which offer more security to buyers afraid that clients will go out of business or otherwise reduce the fees being paid to the buyer.

3. Profitability

This can be a confusing variable to many because it doesn't refer to the seller's profitability but the buyer's. Here is an example: A CPA owns a small firm operated from her home, with her spouse as the only labor. Her profit margin could reach or even exceed 85% because she might not count her spouse as a cost. Now, the CPA moves into an office and hires staff, driving her margin to less than 50%. At this point, would her firm be worth more to the buyer?

If a CPA is selling a firm with little overhead, then a buyer can absorb the practice much more profitably than it can a firm that has lease and staff obligations. Why can't the buyer just jettison staff after the sale? One reason is that many deals require the buyer to keep certain staff. The reasons for such terms are varied, but one often is the seller's belief that holding on to certain staff will lead to higher client retention. Remember, the amount being paid to the seller in most deals depends on how successful the buyer is at keeping clients. The trade-off is that any overhead the buyer is forced to take on likely will result in a lower offer to the seller for the practice. As another example, if the buyer has to treat the purchase as goodwill instead of deducting the payments as made, the deal is more costly.

4. Duration of the Payout Period

Most deals use a range of three to 10 years for the payments, and most do not include added interest. Smaller firms usually are paid in four to six years, and acquisitions of larger firms traditionally have longer payout periods.

THE MULTIPLE

The multiple, finally, is produced by the interaction of all of these other terms and factors. Think of the following equation: the less money upfront, the longer the payout and retention periods, and the more profitably structured for the buyer, the higher the multiple. On the other hand, more money upfront, shorter payout and retention periods, and a less profitable structure for the buyer will result in a lower multiple.

Other factors also affect the sale price. Higher-quality firms—with great clients, higher billing rates and realization, etc.—tend to obtain a higher value. If a CPA is in a marketplace where many accounting firms are looking to buy CPA practices, the demand for the practice is greater and the value is higher. In more remote areas, the supply-and-demand curve is different. The authors have seen small firms sell for as high as 1.25

EXECUTIVE SUMMARY

- **The value of an accounting firm's shares differs for an external sale as opposed to an internal transfer.** However, the methods for determining an accounting firm's value do share a number of factors.
- **The multiple of billings used to determine the sale price is determined by four main factors:** (1) amount of cash, if any, paid upfront; (2) length of the retention period; (3) the deal structure's profitability for the buyer; and (4) length of the payment period.
- **Inside ownership sales usually use a lower multiple than external sales.** Most retiring partners don't expect their partners to pay as much as a stranger.
- **CPAs selling their shares should expect potential buyers to need a financial upside from the deal.** Don't look for buyers to be happy with losing money or breaking even for several years.

Joel Sinkin *(jsinkin@transitionadvisors.com) is president, and* ***Terrence Putney*** *(tputney@transitionadvisors.com) is CEO, both of Transition Advisors LLC in New York City.*

To comment on this article or to suggest an idea for another article, contact Jeff Drew, senior editor, at jdrew@aicpa.org or 919-402-4056.

times billings, even occasionally more in cities such as New York, but have seen firms in more remote areas struggle to get 1 times billings.

Volume also plays a role. Larger firms traditionally receive smaller multiples and longer payout periods. This is predominantly because, in densely populated areas, there may be many firms that can absorb a $500,000 firm into their firm with little to no overhead increases, but no one can absorb a $10 million firm, for example, without substantial increases in overhead. Also, smaller firms tend to yield a higher percentage of profit to the bottom line than larger firms.

Internal Transfers

Although all of the variables of external sales also play a role in an inside transfer of ownership interests, there also are distinct differences. Inside valuations traditionally use a lower multiple of billings than external deals. Most retiring partners don't expect their partners, who helped build the business, to pay the same price as a stranger. Plus, the terms of inside transfers often fix the price at the date of retirement, and the firm is obligated to acquire the ownership interest, both of which justify a lower multiple. Many inside transfers are based on a multiple times billings times ownership interest.

The most popular multiple is still 1 times billings, but less than half of agreements now use that multiple. Very few use more than 1 times, and more than half use less than 1 times. In some cases, the multiple is applied to the book of business the partner managed rather than overall firm billings. Larger firms tend to use a multiple of compensation as opposed to equity. Most of these firms use a formula that looks at the average compensation of a partner over a period of time, multiplied by between two to three times, in most cases, and paid over eight to 10 years (plus capital).

For example, if a retiring partner made an average of $100,000 over the past four or so years, the deal could be structured to pay him or her $300,000 over 10 years. That's in addition to the capital payment. Usually, the capital refers to the retiring partner's share (say 20%) of the accounts receivable and work-in-progress. Most retirement packages are paid in a manner that provides the firm a current deduction such as guaranteed payments to a partner on a Form K-1 or deferred compensation.

So what multiple should be used, whether it is based on equity, a book of business, or compensation? It's good to start with the following premise. The firm has likely helped dozens of clients value a business they were considering buying. In these situations, a CPA would rarely, if ever, tell a client, "If you buy this business, you will lose money, maybe break even for the next seven years. It's a great deal!" The CPA firm's partners should also have financial upside from buying a retiring CPA's interest instead of losing or running in place for seven to 10 years. How can the firm attract young partners if it makes less money after the CPA retires? The following "work backward" formula can test whether the buyout works.

The formula starts with the amount of compensation the retiring partner is making, then subtracts the cost of replacing this partner's labor. That may be as simple as calculating the cost of a high-level staff person to replace the billable time. That leaves the firm with the annual net cash flow it needs to pay the buyout and leave behind reasonable upside. So long as the multiple and other terms the firm chooses enable the remaining partners to have some upside, it is at least a workable start. ❖

AICPA RESOURCES

***JofA* articles**

CPA Firm Succession series

- Part 4: "A Two-Stage Solution to Succession Procrastination," Oct. 2013, page 40
- Part 3: "How to Select a Successor," Sept. 2013, page 40
- Part 2: "The Long Goodbye," Aug. 2013, page 36
- Part 1: "Mergers Emerge as Dominant Trend," July 2013, page 52

Other *JofA* articles

- "Succession Planning: The Challenge of What's Next," Jan. 2013, page 44
- "Planning and Paying for Partner Retirements," April 2012, page 28
- "Traps for the Unwary in CPA Firm Mergers and Acquisitions," Aug. 2011, page 36
- "Mergers & Acquisitions of CPA Firms," March 2009, page 58, and "Keeping It Together: Plan the Transition to Retain Staff and Clients," April 2009, page 24 (two-part article)

Use **journalofaccountancy.com** to find past articles. In the search box, click "Open Advanced Search" and then search by title.

Publication

- *Management of an Accounting Practice Handbook* (#090407, loose-leaf; and #MAP-XX, one-year online subscription)

CPE self-study

- Advanced Mergers, Acquisitions, and Sales: Complex Case Study Analyses for Closely-Held Businesses (#732868)
- Making Key Financial Decisions: Practical Tools and Techniques for Making Your Key Financial Decisions (#733835)

Conferences

- Practitioners Symposium and TECH+ Conference, June 9–11, Las Vegas

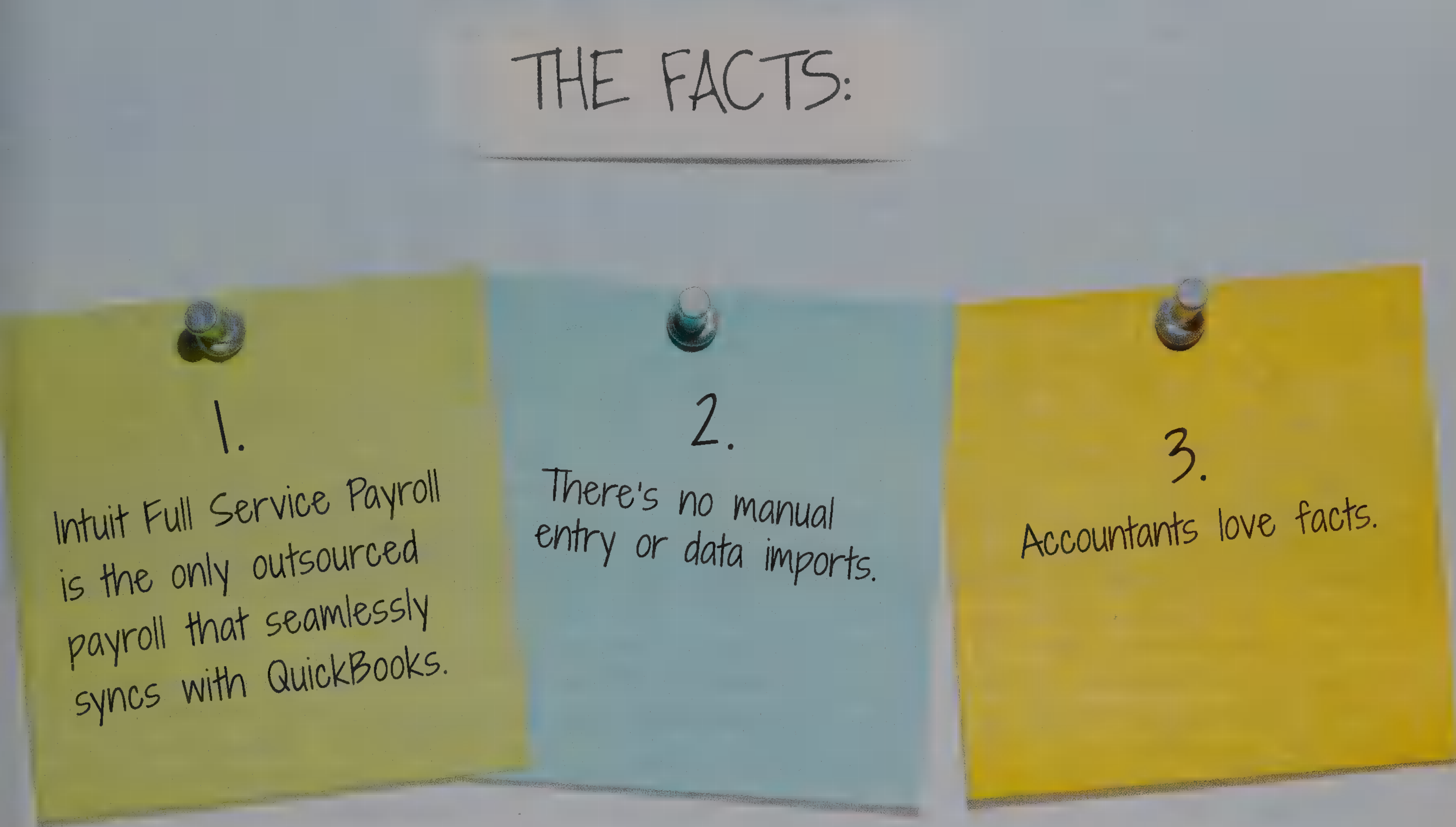
For more information or to make a purchase or register, go to **cpa2biz.com** or call the Institute at 888-777-7077.

Survey reports

- *2012 PCPS Succession Survey* (sole proprietors), **tinyurl.com/ptyegnk**; and *2012 PCPS Succession Survey* (multiowner firms), **tinyurl.com/qzhabug**

Private Companies Practice Section and Succession Planning Resource Center

The Private Companies Practice Section (PCPS) is a voluntary firm membership section for CPAs that provides member firms with targeted practice management tools and resources, including the Succession Planning Resource Center, as well as a strong, collective voice within the CPA profession. Visit the PCPS Firm Practice Center at **aicpa.org/PCPS** and the Succession Planning Resource Center at **tinyurl.com/oak3l4e**.


THE FACTS:
1.
Intuit Full Service Payroll is the only outsourced payroll that seamlessly syncs with QuickBooks.
2.
There's no manual entry or data imports.
3.
Accountants love facts.

Q&A: Top Issues in Business Valuation

Experts discuss topics ranging from changes in fair value measurements to the retirement of the Baby Boomer generation.

by Chris Baysden

Business valuation experts have been practicing in an evolving landscape for the past several years. New standards, changing technology, and an aging population are all playing a part in effecting changes.

The *JofA* organized a round-table discussion of the important issues affecting CPAs who advise clients on business valuation matters. The participants discussed issues such as the effect of the AICPA's new Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs) on fair value determinations, the opportunity presented by the potential demand for valuation services as Baby Boomer business owners near retirement, and the need for valuation practitioners to take on a broader advisory role.

Participating in the round table were:

- **Rosanne Aumiller**, CPA/ABV/CFF, a director at BBP Partners.
- **Randie Dial**, CPA/ABV/CFF, a partner with CliftonLarsonAllen.
- **Nathan DiNatale**, CPA/ABV, a senior manager at SC&H Group.

The following is an edited transcript of the discussion:

What are the emerging trends that you're seeing in business development right now?

Dial: I'm seeing clients wanting more than you just being a valuation guy. They want someone that's going to come in and be more of an adviser and maybe consult with them on ways to create value.

The other big area that I'm seeing is more and more industry specialization in a lot of the proposals I get. Clients and prospects want more and more expertise within certain industries. An example would be financial institutions. If you have not done a financial institution engagement, you're not likely going to get that engagement.

DiNatale: I see the same thing out there with respect to industry specialization. In addition, I frequently see clients that are referred for valuation work where, upon talking to the client, it's not really valuation they are looking for. Rather, it's how can they prepare themselves to potentially sell the company? While they are thinking valuation, what they really need is advisory services. I end up referring them to our capital practice that helps them on an advisory side [with valuation calculations] as opposed to just performing a full blown SSVS1 [Statement on Standards for Valuation Services No. 1] report.

What are the latest developments and challenges with fair value measurements?

DiNatale: I think the most current item facing fair value measurements is how the AICPA Financial Reporting Framework for the Small- and Medium-Sized Entities is going to affect our work moving forward. From a fair value perspective, talking about purchase price allocations and goodwill, I've seen quite a roller coaster ride over the past years, probably five or six years, where it was real heightened up until the decline in 2008 and 2009 where we were getting hammered with goodwill impairments. Then we hit a lull after that where we were not [getting] any new work as it relates to that [goodwill impairments], and it has kind of slowly crept back up. I also think the introduction of the [FRF for

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Changes on the Horizon?

GAAP exceptions for private companies that FASB and the Private Company Council (PCC) are considering include:

- A proposal that would relieve private companies from having to separately recognize certain intangible assets acquired in a business combination.
- A proposal that would permit amortization of goodwill (the residual asset recognized in a business combination after recognizing all other identifiable assets acquired and liabilities assumed), and a simplified goodwill impairment model.

FASB and the PCC were scheduled to discuss public comments on the proposals Oct. 1. Following that discussion, the PCC would have the opportunity to consider changes to the proposals and vote on them. FASB would make the final decision on endorsement before exceptions for private companies are written into GAAP.

SMEs] will be another challenge to get past for those of us dealing in fair value. For example, those privately held smaller companies were required to complete a goodwill impairment test on an annual basis. The FRF for SMEs would permit the amortization of goodwill and therefore eliminate the need for an annual impairment test.

Dial: Assuming fair value measurements are going to continue into the future, I'd say one of the biggest challenges for us is dealing with the latest developments and just keeping up on staying educated on a lot of the new methodologies and things that go on within the field. Some examples would be, just in the last couple of years, guides have been issued on contributory charges and customer relationships. There's also one on contingent consideration. So it's a very difficult thing for fair value practitioners to make sure they're on top of all the newest methodologies and thinking.

How will the current proposal on fair value accounting for private companies impact the work you do for private companies?

DiNatale: I think that it is going to impact the overall number of valuations that we end up doing, to the extent some of those are small businesses. We were affected somewhat by the Level 1 goodwill impairment test, or the pre-Level 1, whereby companies were doing their own analysis, and we were actually assisting. Those cases eliminated the need for additional valuation services in the form of an annual impairment test altogether. And with the FRF for SMEs, I think we will feel the impact a little bit more from a smaller company side. So, to the extent that you perform services for companies that were on the smaller side, you may not see those opportunities anymore.

Dial: Obviously, there's a lot going on in this area. There are exposure drafts out regarding changes to goodwill impairment and also business combination work for private companies. [See the sidebar, "Changes on the Horizon?"] I think on the smaller company side, we're going to see some impact on the amount of work getting done. What that is remains to be seen.

There has also been mention of public companies within that exposure draft, and if something gets passed on the private side, what's going to happen on the public side? I think one big thing to think about as you're going through this proposal and exposure draft is, what does it all mean from a convergence standpoint with IFRS as well?

I think we're all under the impression that we're trying to converge with IFRS, and certainly, taking fair value out of the framework, if you will, is not going to achieve that. So there are a lot of question marks right now, but certainly there are a lot of moving parts to pay attention to.

What do you see happening with business succession in the next five to 10 years as Baby Boomers, both those working at business valuation firms and at companies those firms provide services to, retire?

Aumiller: I think that there are less and less people below me, so to speak, that are interested in doing this kind of work. I don't see a lot in our pipeline. I think for 15 years business valuation was an emerging practice area for CPA firms, and now we've sort of matured in that area. And so we need to keep making sure that we recruit individuals who are going to take over for us.

Dial: When I see this question, opportunity is what pops into my mind. I was recently looking at statistics about how many companies out there will liquidate or look for an exit event within the next five to 10 years. And it's staggering. With this Baby Boomer generation, you have so many business owners out there that are going to be looking at liquidating their nest egg. They have all their wealth tied up in their business, and they're going to need some type of exit.

And what an opportunity that presents to the business valuation community from a consulting standpoint, because those individuals are going to need help getting to that point, possibly creating value and helping them get ready for sale. Who are they going to sell to? Private-equity firms? Strategics? Family members? There are so

many scenarios out there and so many prospects and clients dealing with this. It's just a staggering opportunity for the valuation field to start really taking advantage of, in my mind.

What are the latest opportunities and challenges that you're seeing in regard to technology?

Dial: You know, really, the thing I thought of here was making sure you're staying ahead of the curve on the most up-to-date research tools and databases that keep coming out. I notice every year at the valuation conference there are more and more vendors, it seems, and new companies. The other thing I've really noticed is that valuation is becoming more complex as complex securities within some of these fair value engagements need to be prepared. And then contingent consideration, and a lot of the simulation, and just these real complex models are being developed. Trying to keep up with all of that stuff is very tough.

Aumiller: I'm of a certain age—I won't tell you how old I am, but I'm one of those who can now say I'm old and I'm working with attorneys of a certain age that are five to 20 years older than me who don't use technology.

And I have appreciation of their way of doing things, [but] I think some younger staff may not because they've always had technology in their life. But I work with people who don't even use email sometimes. They send everything first-class mail or by courier. They bring lots of paper and boxes of files to court, for example.

You don't want to alienate your attorney or your business owner or client. And you have to be a little bit patient, and I think try to teach some of our staff how to bridge that gap and how to be more understanding. … I think attorneys that are older and have great client bases because they've been so established, they're willing to work more with people that have that type of attitude. So I think going backward with regard to technology is as important as going forward and looking to all the latest and greatest. ❖

AICPA RESOURCES

JofA articles

- "AICPA Asks Congress to Block Change in DOL Fiduciary Rule for ESOP Appraisers," Aug. 2, 2013, tinyurl.com/n85sxrt
- "Top Concern of FVS Practitioners: Business Development," May 2013, page 38
- "Breaking Into Business Valuation," March 2010, page 43

Use journalofaccountancy.com to find past articles. In the search box, click "Open Advanced Search" and then search by title.

Publications

- *Business Valuation Practice Management Toolkit* (#PPM1208P, paperback; #PPM1211E, ebook; and #PFVSBVTO, one-year online access)
- Forensic and Valuation Services Collection (#PFVSCOLLO, one-year online access)
- *Valuation of Privately-Held-Company Equity Securities Issued as Compensation*, Accounting and Valuation Guide (#AAGSTK13P, paperback; #AAGSTK13E, ebook; and #AAGSTKO, one-year online access)
- *Understanding the Financial Reporting Framework for Small- and Medium-Sized Entities*, AICPA Alert (#AFASME13P, paperback; #AFASME13E, ebook; and #AFASMEO, one-year online access)

CPE self-study

- Fair Value Accounting: A Critical Skill for All CPAs (#733306)
- Introduction to Business Valuation: An Overview of the Business Valuation Process (#745784)
- Understanding Business Valuation (#732885)
- Valuation (#154150, on-demand)

Conference

- Forensic & Valuation Services Conference, Nov. 10–12, Las Vegas (for an online option, go to tinyurl.com/n3oo6ua)

For more information or to make a purchase or register, go to cpa2biz.com or call the Institute at 888-777-7077.

Practice tool

- Business Reference Guide Online, tinyurl.com/ndmurx5

Websites

- Succession Planning Resource Center, tinyurl.com/cx2nauz
- Statement on Standards for Valuation Services No. 1 Toolkit, tinyurl.com/o6wfagh

FVS Section and CFF and ABV credentials

Membership in the Forensic and Valuation Services (FVS) Section provides access to specialized resources in the forensic and valuation services discipline areas, including practice guides. For more information, visit the FVS Center at aicpa.org/FVS. Members with a specialization in financial forensics may be interested in applying for the Certified in Financial Forensics (CFF) credential. Information about the CFF credential is available at aicpa.org/CFF. Members with a specialization in business valuation may be interested in applying for the Accredited in Business Valuation (ABV) credential. Information about the ABV credential program is available at aicpa.org/ABV.

EXECUTIVE SUMMARY

- **Clients want practitioners to be more than just valuation services providers.** They want someone who can be more of an adviser and consult with them on ways to create value.
- **Practitioners are keeping an eye on the current proposal on fair value accounting for private companies.** The proposal could impact the amount of business valuation work that is available.
- **Baby Boomer business owners are or will soon be looking to liquidate their nest egg.** That presents a great business development opportunity to the business valuation community.
- **Even though technology is transforming the way many CPAs operate,** some accountants, lawyers, and clients are sticking to the old ways of doing things. Business valuation practitioners need to be prepared to work with both types of colleagues and clients.

Chris Baysden is a JofA senior editor. To comment on this article or to suggest an idea for another article, contact him at cbaysden@aicpa.org or 919-402-4077.

When the Rules and the Law No Longer Agree

Proceed with care when regulator-prescribed forms do not comply with GAAS.

by Ahava Goldman, CPA, and Thomas A. Ratcliffe, CPA, CGMA, Ph.D.

PHOTO BY ISTOCKPHOTO/THINKSTOCK

In 2012, a form required by the New York City Tax Commission left auditors in a quandary. Recent changes to GAAS that revised the wording of the auditor's report had not been reflected in the form. As a result, the form required auditors to submit a report to the Tax Commission that did not contain the elements and wording that GAAS requires auditors to use.

The Real Estate Committee of the New York State Society of CPAs and the AICPA Audit and Attest Standards Team stepped in to craft a solution, allowing auditors to meet the AICPA Auditing Standards Board's new standards without requiring the city of New York to issue a new form.

But the problem persists in other places. Auditors are finding themselves in the awkward position of having to submit forms that are required by regulators but are not in compliance with state accountancy laws that require auditors to follow GAAS or, for engagements that require a review or compilation, Statements on Standards for Accounting and Review Services (SSARSs).

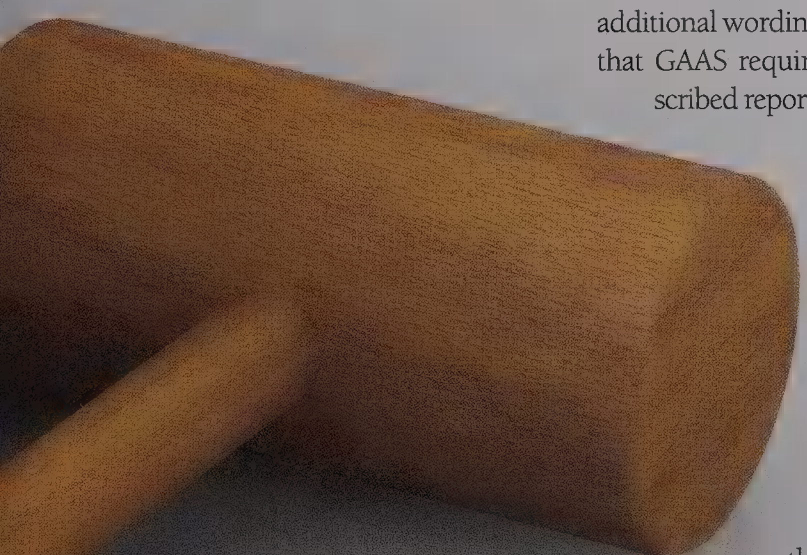
Auditors who determine that a regulator-prescribed report form is not in accordance with the requirements of GAAS may wish to contact the regulator to determine if a reworded form or separate report will be accepted. Auditors may wish to contact their state societies to work with them and the regulator to resolve the issue. The AICPA developed a webpage (available at tinyurl.com/mrq2fso) with resources to assist practitioners, including a sample letter for contacting a regulator about prescribed report forms that do not comply with GAAS.

But the situation may take time to resolve. In the meantime, here is how auditors should proceed when confronted with such a problem.

The Auditor's Report

When a regulator prescribes the form of an auditor's report, the auditor is permitted to refer to GAAS only when the auditor's report includes the elements required by GAAS (see Exhibit 1). Statement on Auditing Standards (SAS) No. 122, *Clarification and Recodification*, revised the wording of the auditor's report. The description of management's responsibilities and description of an audit particularly changed in the revision. As a result, many regulator-prescribed forms may no longer be in accordance with GAAS.

If the prescribed form does not contain the minimum required reporting elements and wording, GAAS requires the auditor to reword the prescribed form of the report or attach an appropriately worded separate report. Some regulator-prescribed report forms can be made acceptable by inserting additional wording to include the elements that GAAS requires. Other regulator-prescribed report forms need complete revision to be acceptable because the prescribed language of the report calls for statements that are inconsistent with the auditor's function or responsibility. An example of this would be a regulator-prescribed report form that requests the auditor to certify the financial statements. The NYC Tax Commission agreed to allow auditors either to insert footnotes in the form that contained the appropriate wording or to attach a separate report.



Preparation of the Financial Statements

In determining the appropriate form and content of the auditor's report, auditors need to consider various factors, including financial statement preparation and presentation.

GAAS requires the auditor to consider whether the financial reporting framework to be applied in preparing the financial statement(s) is acceptable. The financial statement(s) may be prepared in accordance with a general-purpose framework, such as GAAP, or a special-purpose framework (commonly referred to as an other comprehensive basis of accounting, or OCBOA), such as a regulatory framework.

In the absence of indications to the contrary, a financial reporting framework prescribed by a regulator is presumed acceptable. In some instances, a regulator requires financial statements to be prepared in accordance with a financial reporting framework that is based on GAAP but does not comply with all of its requirements. Such frameworks are regulatory bases of accounting. It is inappropriate for the description of the applicable financial reporting framework in such financial statements to imply full compliance with GAAP. An appropriate description would state that the financial statements are prepared in accordance with the regulator's requirements.

Presentation of the Financial Statements

GAAS requires the auditor to evaluate whether the financial statements achieve fair presentation in accordance with the applicable financial reporting framework. One basic step in this consideration is determining that the financial statements include all informative disclosures that are appropriate for the applicable financial reporting framework, including matters that affect their use, understanding, and interpretation.

When the financial statements prepared in accordance with a regulatory basis of accounting contain items that are the same

Exhibit 1 Auditor's Report Required Elements

This table describes the elements required by GAAS to be included in an auditor's reports and describes the changes as a result of the issuance of SAS No. 122, *Clarification and Recodification*.

Required Element	Comment
a. A title	*No change.*
b. An addressee	Form usually includes addressee.
c. An introductory paragraph that identifies the financial statements audited	Includes reference to the related notes to the financial statements, because the definition of "financial statements" includes the related notes.
d. A description of management's responsibility	Revised wording: "Management is responsible for the preparation and fair presentation of these financial statements in accordance with the [*state basis of accounting*]. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error."
e. A reference to management's responsibility for determining that the applicable financial reporting framework is acceptable when management has a choice of financial reporting frameworks to use	Note that often regulators prescribe the financial reporting framework to be used, in which case this is not applicable.
f. A description of the purpose for which the financial statements are prepared or reference to a note in the financial statements that contains that information in certain circumstances	New requirement that now pertains to all financial statements prepared in accordance with a regulatory or contractual basis of accounting.
g. A description of the auditor's responsibility to express an opinion on the financial statements (or special-purpose financial statements) and the scope of the audit, that includes	See below.
i. A reference to GAAS and, if applicable, the law or regulation	*No change.*
ii. A description of an audit in accordance with those standards	Revised wording: "Our responsibility is to express an opinion on the financial statement based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statement is free from material misstatement. "An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements. "We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion."

(Continued on page 42)

Exhibit 1 Auditor's Report Required Elements

(Continued from page 40)

Required Element	Comment
h. An opinion paragraph containing an expression of opinion on the financial statements (or special-purpose financial statements) and a reference to the general-purpose framework (or special-purpose framework) used to prepare the financial statements (or special-purpose framework), including identifying the origin of the framework	*No change.*
i. An *emphasis-of-matter* paragraph that indicates that the financial statements are prepared in accordance with a special-purpose framework (when applicable)	The placement of the paragraph within the auditor's report has changed; however, the placement may vary in a prescribed form.
j. An *other-matter* paragraph that restricts the use of the auditor's report when the financial statements are not intended for general use	*No change.*
k. The auditor's signature	*No change.*
l. The auditor's city and state	New requirement; however, many prescribed forms request this.
m. The date of the auditor's report	*No change.*

Source: AU-C Section 800, *Special Considerations–Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), Ahava Goldman, and Thomas A. Ratcliffe.

as, or similar to, those in financial statements prepared in accordance with GAAP, informative disclosures similar to those required by GAAP are necessary to achieve fair presentation. If just a single financial statement is presented, only the disclosures related to that financial statement are necessary. For example, financial statements prepared on a regulatory basis of accounting usually reflect depreciation, long-term debt, and owners' equity, so the informative disclosures for those items would be comparable to those in financial statements prepared in accordance with GAAP.

Such disclosures are necessary for fair presentation and need to be provided regardless of whether the regulator specifically requires them. If the form prescribed by the regulator does not provide for disclosures, the necessary disclosures should be attached to the prescribed form. If the disclosures necessary for fair presentation are not provided, the financial statements are materially misstated, and a modification to the auditor's opinion on the financial statements is required.

Review and Compilation Reports

A regulator may request that an independent accountant perform a review engagement, with the financial statement and accountant's report submitted on regulator-prescribed forms. Just as in an audit engagement, an accountant who encounters regulator-prescribed forms in a review engagement is required to consider the fair preparation and presentation of the financial statements—and the wording and elements of the accountant's report. If a regulator's prescribed report does not include the specific elements and wording required by SSARSs for a review report, the accountant should reword the form or attach a separately worded report.

EXECUTIVE SUMMARY

- **Many regulators require that independent auditors provide an opinion** on financial information that is submitted to a regulator, often by means of an auditor's report on forms prescribed by the regulator.
- **Auditors engaged to submit reports on prescribed forms need to consider** what the regulator is requesting of the auditor. Many regulators use language that is not consistent with the language used in GAAS.
- **If the minimum required reporting elements and wording are not contained in the prescribed form,** GAAS requires the auditor to reword the prescribed form of the report or attach an appropriately worded separate report.
- **Similar considerations apply** when practitioners are requested to report on prescribed forms in review or compilation engagements.

Ahava Goldman *(agoldman@aicpa.org) is a senior technical manager with the AICPA Audit and Attest Standards Team.* ***Thomas A. Ratcliffe*** *(tomr@wilsonprice.com) is senior accounting and auditing technical director for Warren Averett LLC and director emeritus at the school of accountancy at Troy University.*

To comment on this article or to suggest an idea for another article, contact Ken Tysiac, senior editor, at ktysiac@aicpa.org or 919-402-2112.

More commonly, a regulator will request that financial statements be compiled. In a compilation engagement, there is a presumption that the information required by a prescribed form meets the needs of the body that designed or adopted the form and that there is no need for that body to be advised of departures from the applicable financial reporting framework required by the prescribed form or related instructions. When the financial statements have been prepared in accordance with GAAP, but the prescribed form fails to include the disclosures or presentation required by GAAP, the accountant's compilation report should include:

- A description of management's responsibility for the preparation and fair presentation of the financial statements in accordance with GAAP.
- A paragraph stating that "The financial statements included in the accompanying prescribed form are presented in accordance with the requirements of [*name of regulatory body*], and are not intended to be a complete presentation in accordance with accounting principles generally accepted in the United States of America."

However, in such engagements, if the accountant becomes aware of a departure from GAAP other than lack of disclosures or presentation, then the accountant should consider whether modification of the standard report is adequate to disclose the departure.

An accountant may have reviewed financial statements, including disclosures required by GAAP, and be asked to compile financial statements included in a prescribed form that does not request such disclosures. When the difference between the previously reviewed financial statements and the financial statements included in the prescribed form is limited to the omission of disclosures not requested by the form, the accountant may refer to the accountant's report on the reviewed financial statements in the accountant's report on the compiled financial statements included in the prescribed form. This might be accomplished by adding a sentence to the introductory paragraph of the report or a separate paragraph, such as the following: "These financial statements were compiled by me (us) from financial statements for the same period which I (we) previously reviewed, as indicated in my (our) report dated________." The reference to a previous review report should include a description or a quotation of any modifications of the standard review report previously issued and of any paragraphs emphasizing a matter regarding the financial statements.

HANDLE WITH CARE

Practitioners who are asked to provide an opinion on financial information that is submitted to a regulator, by means of an auditor's or accountant's report on forms prescribed by the regulator, need to be aware of the possibility that the form may not meet the requirements of GAAS or the SSARSs. In these situations, following proper procedures is essential, and contacting the regulator can help correct the problem for the future. ❖

AICPA RESOURCES

JofA article

- "Auditing Transition," May 2012, page 22

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Publication

- AICPA *Professional Standards*, AU-C Sections 700, 725, 800, and 825, and AR Sections 80, 90, and 300 (#APS13P, paperback; and #WPS-XX, one-year online access)

CPE self-study

- Top Audit Issues: Current Issues Facing CPAs (#745203)

Conference

- Current SEC and PCAOB Developments, Dec. 9–11, Chicago; New York City; San Francisco; and Washington

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Website

- AICPA webpage devoted to addressing changes that may be needed when an auditor is required to submit an auditor's report on forms prescribed by the regulator, tinyurl.com/mrq2fso

Before You Sign:
Natural Gas Lease Tax Issues

As more states permit fracking to recover shale gas, CPAs will increasingly encounter clients with tax issues arising from this activity.

by Sally P. Schreiber, J.D.

The practice of extracting natural gas from shale through hydraulic fracturing, commonly referred to as "fracking," is becoming more widespread throughout the country. It is essential for practitioners to understand the tax issues that could arise for clients who own property with shale gas deposits.

From 2001 to 2011, Americans signed more than a million leases to allow energy producers to drill for natural gas on their land. In some states, people have been receiving income from leases on their properties for a number of years, even though no drilling may have occurred. As more states permit fracking, many more landowners will be approached by energy companies to enter into leases.

In areas with economically viable and legal shale plays, energy companies typically send out "landsmen" (including women) to negotiate with landowners for leases to permit drilling wells and to pay royalties for any gas extracted. (A shale play refers to a geographic area that has been targeted for exploration because it contains an economically viable quantity of oil or natural gas.) Many landowners who entered into leases before anyone realized how valuable the shale gas deposits would become signed leases for as little as $3 an acre, but now leases can be much more lucrative. In 2012, the going rate for leases in Ohio was more than $5,000 an acre.

Many landowners are farmers or other individuals who may be unfamiliar with how their tax situation will change if they enter into a lease and receive income from the energy companies. In other cases, shale plays may be on land owned by tax-exempt organizations, such as hunting clubs, country clubs, or homeowners' associations. This raises other unique tax issues. This article addresses the tax treatment of fracking for these two groups of taxpayers, but it does not address the loss limitation rules that apply to farmers.

An estimated 750 trillion cubic feet of technically recoverable natural gas is trapped in shale formations in the lower 48 U.S. states; 86% is located in the Northeast, Gulf Coast, and the Southwest. The largest shale play by geographic area, the Marcellus shale, which extends into parts of Maryland, New York, Ohio, Pennsylvania, Virginia, and West Virginia, holds 55% of the total technically recoverable gas. There are also active shale plays in Alabama, Arkansas, Colorado, Illinois, Indiana, Kentucky, Louisiana, Michigan, Mississippi, North Dakota, Tennessee, Texas, Wyoming, and elsewhere in the United States. Other areas have the potential for gas production. The Monterey shale in California, for example, has significant oil and natural gas deposits, but the state does not permit fracking.

Mineral Rights

One immediate issue to determine is whether the landowner also holds the land's mineral rights. Land rights in the United States are sometimes split estates, meaning one person owns the surface rights and another owns the mineral rights. This can affect whether the surface owner receives compensation for drilling on the land. The answer is controlled by local law.

For example, in California, if the estate is split, the surface right owner is usually compensated for access to the land. However, in West Virginia, because of aggressive actions by companies to sever surface rights from mineral rights, many individuals do not own the mineral rights to their land, do not control fracking on their land, and are limited in their compensation from energy companies. New Mexico and Colorado, however, have enacted legislation requiring owners of surface rights to be compensated when drilling occurs on their land.

Lease Payments vs. Royalties

Payments the energy companies make to landowners for allowing them to drill on property are usually referred to as lease payments. Amounts paid based on the amount of gas extracted are royalties. The two types of income have different tax treatments.

Rent is a fixed amount, payable over a fixed period, that compensates the owner for the use of the property and does not vary based on the use of the property. Royalties, on the other hand, are based on the use of the property. Distinguishing between the two can be difficult if the contract is unclear—if the contract does not distinguish between payment of rent and royalties, a court may hold that all payments under the contract are royalties.

Land Lease Payments

Amounts received for upfront land leases that energy companies pay to be permitted to drill on the land are rental income for federal income tax purposes, which means the payments will be ordinary income from a passive source under Sec. 469. As a result, this income cannot be offset by other losses from nonpassive activities, such as losses from farming if the individual actively participates in farming.

The lease payments are either made annually for the life of the lease or upfront at the beginning of the lease term. As cash-basis taxpayers, most individuals will have to pay tax on all upfront payments in the year received. Accrual-basis taxpayers will apply the all-events test, which may result in the income's not all being immediately taxable. (For payments over $250,000, see Sec. 467, which requires accrual of rental payments in certain circumstances.)

Income from lease payments can be reduced by related expenses, such as attorneys' fees, property taxes, surveying fees, and title costs.

Higher-income taxpayers are subject to Sec. 1411's new 3.8% investment income tax on this income. The tax applies to the lesser of the taxpayer's net investment income for the tax year or the excess (if any) of the individual's modified adjusted gross income for the tax year over a threshold amount. The threshold amounts are $250,000 for married taxpayers filing jointly and surviving spouses, $125,000 ➤

for married taxpayers filing separately, and $200,000 for other taxpayers.

Royalties

Typically, agreements with energy companies provide for royalties of a certain percentage of the amount of revenue a well produces. (Pennsylvania sets a minimum of 12.5%; the average royalty nationwide is 18.75% (see "Pennsylvania Fracking Royalties Could Top $1 Billion as Private Landowners Rake In Cash," *Business Insider*, tinyurl.com/b4saavd)). Royalties, like land lease payments, are ordinary income, but they are not treated as passive under Sec. 469; instead they are portfolio income and, as such, can offset losses from other business activities in which the individual participates. Similar to the land lease payments, royalty income will potentially subject higher-income taxpayers to the 3.8% net investment income tax.

Depletion

The amount of taxable royalties, but not land lease payments, may be reduced by a depletion deduction, calculated either under the percentage depletion method or the cost depletion method.

Landowners are more likely to qualify for percentage depletion. The amount of the percentage depletion deduction is 15% of the taxpayer's gross income from the property, limited to the lesser of the taxpayer's taxable income from the property or 65% of the taxpayer's taxable income.

Cost depletion involves dividing a taxpayer's cost for the investment in the property by the estimated value of the total recoverable amount of the natural gas. To use the cost depletion method, taxpayers must have a cost basis in the property they are depleting. In most cases, when individual taxpayers originally bought the land on which the shale gas deposits were later discovered, they did not establish a separate cost basis for their mineral rights because that was not the purpose of the land acquisition. Those taxpayers therefore do not have a basis to use to depreciate the mineral rights and must use the percentage depletion method.

Estimated Tax

Many of the people who own large tracts of land with shale gas deposits are farmers. Often, the discovery of natural gas on a tract of land can help struggling farmers pay their bills and keep land in the family. However, these farmers may be unaware of how receiving income from these natural gas deposits may change their responsibility to pay estimated tax.

The Code has special estimated tax rules for qualified farmers. An individual is a qualified farmer if two-thirds of the individual's gross income from all sources is from farming. A qualified farmer does not have to pay estimated tax if the qualified farmer files his or her return and pays his or her taxes in full by March 1. Gross income from farming is income from cultivating the soil or raising agricultural commodities, including income from operating a stock, dairy, poultry, bee, fruit, or truck farm (a farm that grows vegetables for market) and from a plantation, ranch, nursery, range, orchard, or oyster bed.

Income from land leases and natural gas royalties does not constitute gross income from farming, and if it exceeds one-third of the farmer's gross income, the farmer is required to pay estimated taxes to avoid an underpayment penalty (Sec. 6654). In addition, landowners who are not farmers and who receive large amounts from leases and/or royalties may not realize that they are now subject to estimated tax. This is especially true for individuals who are salaried—all their income tax has been paid in the past by withholding, and the last thing they are thinking about is having to make quarterly estimated tax payments.

Other Tax Issues

Self-employment tax. The good news for landowners is that Self-Employment Contributions Act (SECA) tax generally does not apply to lease or royalty payments because the payments are not received in the course of a trade or business. The key is that the landowner must not have an "operating or working interest" in the lease and therefore is not engaged in a trade or business (Rev. Rul. 83-102).

State and local taxes. Generally, payments landowners receive also will be subject to state income taxes and, in some cases, local taxes, but this is beyond the scope of this article.

Estate planning. Because mineral rights are usually severable from the fee title on land, individuals who own land with shale gas deposits should consult tax and estate planning practitioners for the best way to leave these income streams to children, grandchildren, and later generations,

EXECUTIVE SUMMARY

- **Shale gas deposits have been discovered** in many areas throughout the United States. Many taxpayers may find themselves owning land with these deposits.
- **Income from shale deposits** may be rental income from leases or royalty income from the payments made for natural gas that is extracted.
- **The lease payments are passive income,** while royalty income is not passive–it may be used to offset losses from active sources, such as losses from farming.
- **Taxpayers may want to create a separate tax entity** to receive the income from the property.
- **Farmers with shale gas deposits on their land who have not paid estimated tax** may find that the income from the shale gas deposits is high enough that they will now be required to make estimated tax payments.
- **Tax-exempt entities that have shale gas deposits on their land** face special tax issues, including unrelated business income taxes and the prohibition against inurement.

Sally P. Schreiber is a JofA *senior editor. To comment on this article or to suggest an idea for another article, contact her at sschreiber@aicpa.org or 919-402-4828.*

including the best ways to minimize federal and state taxes. One method is to take advantage of the annual exclusion from the gift tax to make gifts to these family members or to trusts for their benefit.

Should Taxpayers Form an Entity?

Before signing a lease, taxpayers may want to consider forming an entity to receive lease payments and royalties. To avoid C corporation double-taxation issues, taxpayers will generally want to form a passthrough entity, either a limited liability company (LLC) or an S corporation. S corporations can be good vehicles to hold these interests, but with their limitations on the number and types of shareholders and the requirement that distributions be pro rata to shareholders, they can present a "trap for the unwary." In addition, taxpayers need to be aware that S corporations that have converted from C status and have accumulated earnings and profits from their C corporation years are subject to the Sec. 1375 tax on excess net passive investment income when their passive investment income exceeds 25% of gross receipts in a year. If the S corporation's passive investment income exceeds 25% of gross receipts for three consecutive years, its S corporation election will terminate.

LLCs (which are disregarded as separate entities for federal tax purposes if they have only one member, and usually elect to be partnerships if they have two or more members) provide protection from liability while permitting business flexibility. For this reason, many individual taxpayers with shale gas interests choose this form to operate that part of their business activities.

Land Owned by Tax-Exempt Organizations

Many landowners with large pieces of land that contain shale gas plays are tax-exempt organizations, such as country clubs, hunting clubs, or homeowners' associations. A number of these organizations qualify under Sec. 501(c)(7) as clubs organized for pleasure, recreation, or other nonprofit purposes. For these organizations to qualify for tax-exempt status, substantially all of their activities must be for those purposes, and none of their earnings can inure to the benefit of private shareholders.

A few tax rules may cause problems for these types of organizations if they earn rental income or royalties from gas leases. First, Sec. 501(c)(7) organizations are subject to the rules on unrelated business taxable income. If a social club earns royalties and land lease rental payments, it is subject to tax on those amounts because the income is not from activities related to the organization's exempt purpose. Under Sec. 512(a)(3), all of a Sec. 501(c)(7) organization's income is taxable unless it is exempt-function income (generally dues and other money received from members for goods, facilities, or services provided in the furtherance of the organization's exempt purpose). The taxable amount can be reduced by allocable expenses, such as survey or title expenses incurred in executing the lease.

A much bigger problem arises from the income itself. Social clubs must meet a gross receipts test, which prohibits them from earning more than 35% of their income from sources other than membership dues, fees, and assessments and revenue from members for the use of club facilities or in connection with club activities. Violating the 35% test can terminate an organization's exemption. However, if the club violates this test, the IRS will take all facts and circumstances into account in determining whether the organization qualifies for exempt status.

In addition, if it is found that the income an organization earns inures to the benefit of any member, the organization will lose its tax-exempt status. If a Sec. 501(c)(7) organization uses its natural gas revenues to improve its facilities for its members without raising dues, this could be considered inurement.

A central case in the inurement area involved a duck-hunting club in Louisiana that lost its tax exemption after leasing part of its property for the exploration and production of oil and gas. The lease revenue was used to pay for the majority of the amounts required and expended by the club for operations, repairs, maintenance, and improvements or was invested in government bonds (*Coastal Club, Inc.*, 43 T.C. 783 (1965), aff'd, 368 F.2d 231 (5th Cir. 1966)).

Conclusion

No matter what else happens in the development of energy in the United States, fracking is probably here to stay. And because the shale deposits are in so many places around the country, it may be possible to see fracking wells as frequently as oil wells appeared in Texas beginning in the early 20th century.

Farmers, homeowners, and almost anyone who lives in the vast areas in which shale gas can be found may want to get in on this new energy boom. In some cases, landowners may not hold the mineral rights, but they will still be compensated for drilling on their land. Taxpayers who own surface and mineral rights may want to split them so they can pass a steady income stream to their descendants. Because so many different types of taxpayers may be affected, CPAs and other tax advisers should be prepared to offer federal and state income tax advice and estate planning. ❖

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Act Before the Deadline: Exclusion of 100% of QSBS Gain

Take steps before the end of 2013 to apply favorable rules on gain from the sale of qualified small business stock.

by Laura Jean Kreissl, Ph.D., and Darlene Pulliam, CPA, Ph.D.

Taxpayers have a short window in which to act if they want to take advantage of the Sec. 1202 provision that allows exclusion of 100% of the gain realized on the sale or exchange of qualified small business stock (QSBS). Unless the law is amended, for QSBS acquired after Dec. 31, 2013, the Sec. 1202 exclusion percentage will fall to 50%, and an alternative minimum tax (AMT) preference will further erode the exclusion's advantages.

Currently, Sec. 1202 allows exclusion of 100% of the gain realized on the sale or exchange of QSBS for stock that is acquired after Sept. 27, 2010, and before Jan. 1, 2014, and held for more than five years. The exclusion applies to noncorporate taxpayers within certain tax-year limits.

In addition, the Sec. 57(a)(7) AMT preference for a portion of the gain excluded under Sec. 1202 does not apply to QSBS purchased within this period (Sec. 1202(a)(4)). Because the deadline for acquiring stock that will qualify for the more favorable treatment is rapidly approaching, investors should plan to complete any purchases of stock that could qualify as QSBS before the end of the year.

Requirements Under Sec. 1202

Qualified Small Business Stock

Stock qualifies as QSBS only if it meets all of the following tests:

- It must be stock in a C corporation (i.e., not S corporation stock) originally issued after Aug. 10, 1993.
- As of the date the stock was issued, the corporation was a domestic C corporation with total gross assets of $50 million or less (a) at all times after Aug. 9, 1993, and before the stock was issued, and (b) immediately after the stock was issued. Gross assets include those of any predecessor of the corporation, and all corporations that are members of the same parent-subsidiary controlled group are treated as one corporation.
- In general, the taxpayer must have acquired the stock *at its original issue* (either directly or through an underwriter), either in exchange for money or other property or as compensation for services (other than as an underwriter) to the corporation.
- During "substantially all the time" (a term that is not defined in the statute or in IRS guidance) the taxpayer held the stock:
  - The corporation was a C corporation;
  - At least 80% of the value of the corporation's assets was used in the "active conduct" of one or more qualified businesses; and
  - The corporation was not a foreign corporation, domestic international sales corporation (DISC), former DISC, regulated investment company (RIC), real estate investment trust (REIT), real estate mortgage investment conduit (REMIC), cooperative, or a corporation that is eligible to make (or has a subsidiary that is eligible to make) a Sec. 936 election.

Per-Issuer Limit

For each tax year, for each corporation in which the taxpayer sells or exchanges QSBS, the amount of gain eligible for the exclusion cannot exceed the greater of:

PHOTO BY ISTOCK/THINKSTOCK

- $10 million ($5 million for married persons filing separately), less the total amount of eligible gain (i.e., gain on the sale or exchange of QSBS held for more than five years) taken into account under the Sec. 1202(a) rules by the taxpayer with respect to dispositions of stock issued by the corporation in all earlier tax years; or
- 10 times the taxpayer's total adjusted basis in QSBS of the corporation disposed of by the taxpayer in the tax year (Sec. 1202(b)(1)).

Note that the first limit is expressed as a dollar cap of $10 million ($5 million for separate filers) and also is a cumulative cap for dispositions of stock of the same corporation. By contrast, the second limit does not have a dollar cap—instead, the limit is calculated using the basis in the QSBS shares—and is an annual limit. Thus, by stretching out sales of QSBS of the same corporation, a taxpayer may be able to exclude more than $10 million of gain.

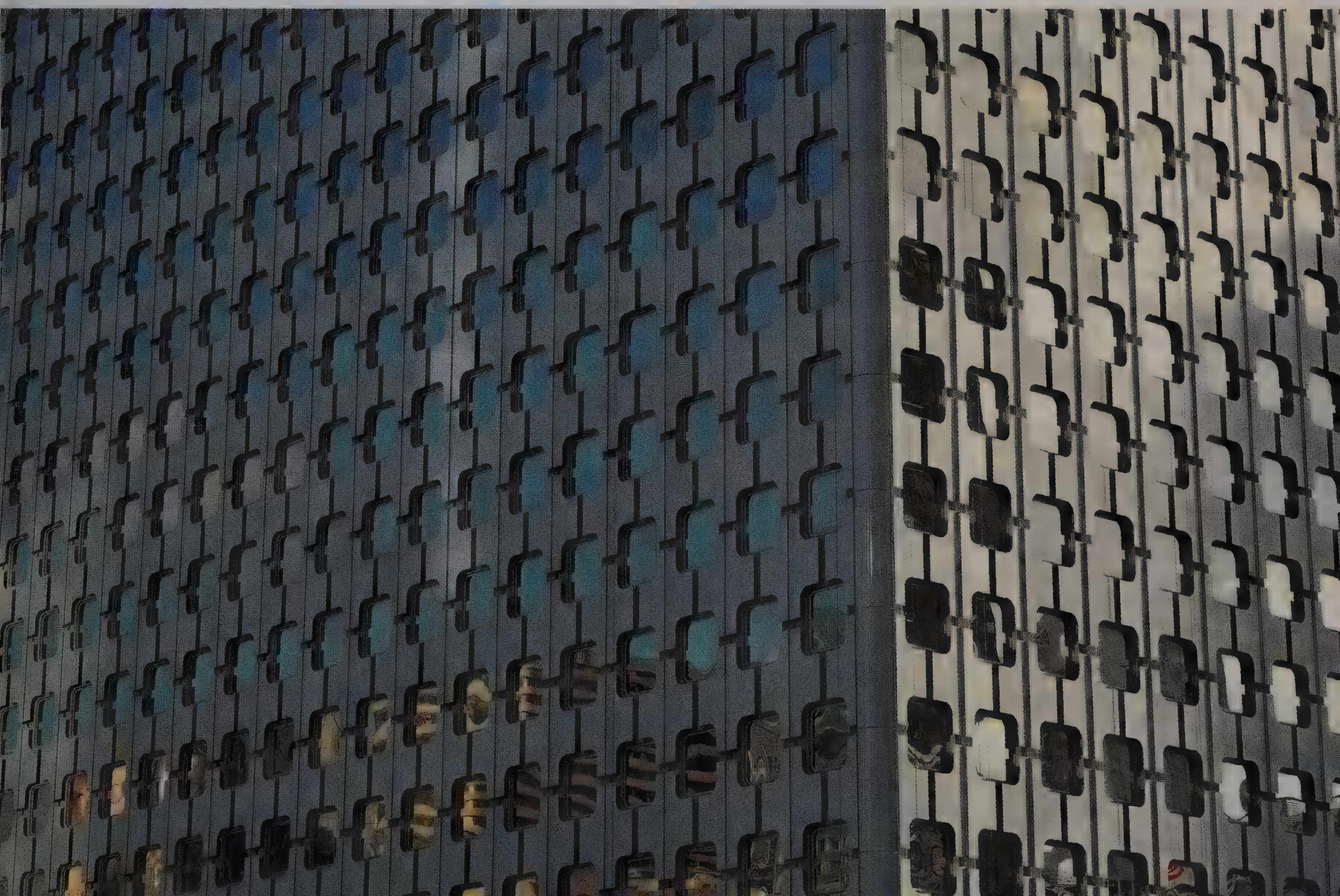
Active Business Requirement

At least 80% of the value of the corporation's assets must be used in the "active conduct" of one or more qualified businesses. Assets used in the active conduct of a qualified business include:

- Assets used in certain activities relating to *future* qualified businesses, without regard to whether the corporation has any gross income from these activities at the time this rule is applied. Those activities are:
  - Sec. 195(c)(1)(A) startup activities;
  - Activities that result in paying or incurring qualifying research and experimental expenditures under Sec. 174; and
  - Activities relating to in-house research expenses (Sec. 1202(e)(2));
- Assets held to meet the "reasonably required working capital needs" of a qualifying business and assets held for investment that are reasonably expected to be used within two years to finance research and experimentation in a qualified business or to finance increases in the working capital needs of the business (Sec. 1202(e)(6)); and
- The rights to computer software that produces active business computer software royalties as defined in Sec. 543(d)(1) (Sec. 1202(e)(8)).

A corporation is treated as failing to meet the active conduct requirement for any period during which:

- More than 10% of the value of its assets in excess of its liabilities consists of stock or securities in other corporations that are not subsidiaries, other than working capital assets (Sec. 1202(e)(5)(B)); or
- More than 10% of the total value of its assets consists of real property that is not used in the active conduct of a qualified



business (for this purpose, owning, dealing in, or renting real property is not considered to be the active conduct of a qualified business) (Sec. 1202(e)(7)).

For QSBS purposes, a qualified business cannot be a business involving services performed in the fields of health, law, engineering, architecture, accounting, actuarial science, performing arts, consulting, athletics, financial services, or brokerage services or any other trade or business whose principal asset is the reputation or skill of one or more employees (Sec. 1202(e)(3)).

No statute, regulation, or congressional committee report gives insight as to Congress's intent regarding the intangible human qualities "reputation" or "skill." Thus, it is unclear which trades or businesses will fail the qualified business test as a result of this language, or which more-specific characteristics of any given trade or business would cause a business to fail this test.

AMT Implications

Current law provides an exception to the treatment of a portion of the gain excluded under Sec. 1202 as an AMT tax preference for QSBS acquired after Sept. 24, 2010, and before Jan. 1, 2014 (Sec. 1202(a)(4)(C)). For stock acquired on or after Jan. 1, 2014, the AMT preference will apply to gain excluded under Sec. 1202.

Net Investment Income Tax

Starting in 2013, a 3.8% surtax applies to the net investment income of taxpayers with modified adjusted gross income exceeding a specific threshold ($250,000 for married taxpayers filing jointly, $125,000 for married taxpayers filing separately, and $200,000 for other individual taxpayers). The gain excluded under Sec. 1202 presumably should not be subject to the net investment income tax because that tax applies to net gain only to the extent it is taken into account in computing taxable income (Sec. 1411(c)(1)(A)(iii)).

Impending Deadline

Individual taxpayers who acquire stock before the end of this year that qualifies as QSBS when it is sold will be able to exclude 100% of the gain on the sale from both regular tax and AMT. However, gain from the sale of QSBS acquired in 2014 may qualify for only a 50% gain exclusion, and a portion of the gain may be an AMT preference item. Therefore, investors should plan to complete purchases of stock that could qualify as QSBS before the end of 2013. ❖

AICPA RESOURCES

JofA article

- "Tax Practice Corner: A Limited-Time Opportunity for Small Business Stock," Dec. 2009, page 71

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Publication

- *Adviser's Guide to the Tax Consequences of the Purchase and Sale of a Business*, Second Edition (#091025)

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EXECUTIVE SUMMARY

- **Qualified small business stock (QSBS) acquired before the end of 2013** and held for five years before sale qualifies for a 100% exclusion from income of any capital gain upon its sale, for regular and alternative minimum tax purposes.
- **To qualify as QSBS, the stock must be issued by a C corporation** with total gross assets of $50 million or less at all times and at least 80% of whose assets are used in an active trade or business.
- **To qualify to exclude the gain, a taxpayer must be a noncorporate shareholder** who has held the stock since it was issued. There are also limits on the amount of stock that can be excluded.
- **QSBS is even more valuable now that the capital gain tax rate** is higher for high-income taxpayers. The gain from the sale of QSBS is also not subject to the new 3.8% tax on net investment income.
- **Taxpayers have a narrow window to acquire stock that qualifies for the 100% exclusion** (the stock must be held for five years before it is sold regardless). They must acquire the stock by Dec. 31, 2013.

***Laura Jean Kreissl** (lkreissl@wtamu.edu) is an assistant professor, and **Darlene Pulliam** (dpulliam@wtamu.edu) is Regents Professor and McCray Professor of Accounting. Both teach in the College of Business at West Texas A&M University, Canyon, Texas.*

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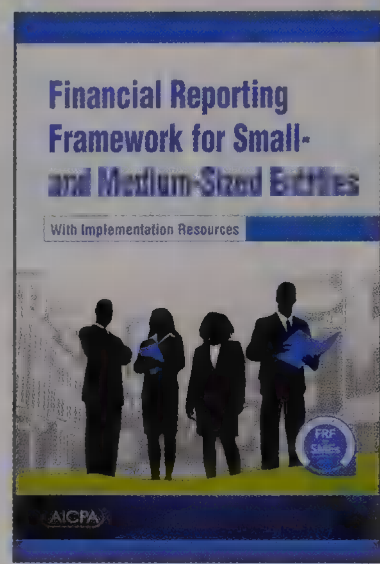
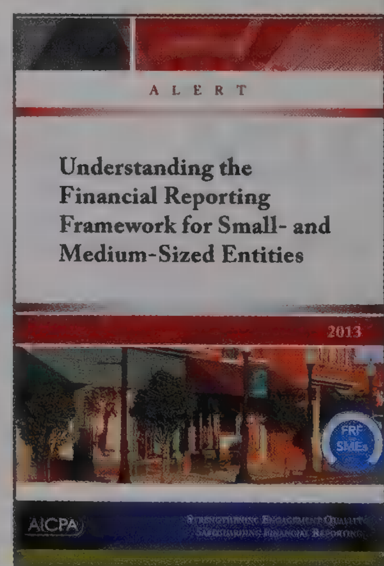
Financial Reporting Framework for Small- and Medium-Sized Entities Gains Traction



Private company financial reporting has evolved more in the past year or so than during the previous four decades. In June, the AICPA issued the FRF for SMEs™ accounting framework, which is designed for America's small business community whose financial statements do not require U.S. GAAP as the basis of accounting. It delivers financial statements that provide useful, relevant information in a simplified, consistent, cost-effective way.

The AICPA's *Financial Reporting Framework for Small- and Medium-Sized Entities* (FRF for SMEs™) is specifically designed to fulfill the financial reporting needs of small- and medium-sized entities. When GAAP-based financial statements are not required, the FRF for SMEs™ is an ideal accounting basis for owner-managers and users who need financial statements that are prepared in a consistent and reliable manner in accordance with a framework that has undergone professional and public scrutiny.



Along with the FRF for SMEs framework, the AICPA has developed implementation resources to assist owner-managers of SMEs, their external CPAs, and those who use their financial statements. This guidance includes illustrative financial statements; a presentation and disclosure checklist; illustrative application examples; and sample audit, compilation and review reports. Although separate from the framework, the implementation guidance is included to give CPAs a more complete resource for adopting and using the framework.

To further help CPAs see the benefits of the new framework, the AICPA has developed *Understanding the Financial Reporting Framework for Small- and Medium-Sized Entities*, which highlights the framework's purpose for privately owned small- and medium-sized entities, and explains many of its accounting principles. Comparisons to other commonly used frameworks, such as U.S. GAAP and the income tax basis of accounting, are provided to give readers practical insight in the suitability of the framework to their business or clients. The Alert also explains the transition requirements related to the adoption of the FRF for SMEs.

Whether you're just gathering information, or have already decided on adoption, AICPA has the resources you need to understand and implement this financial reporting framework.

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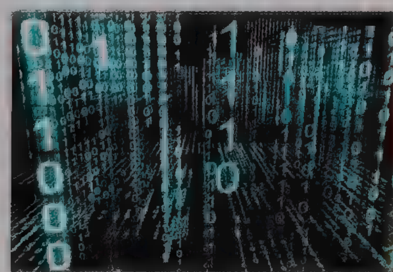

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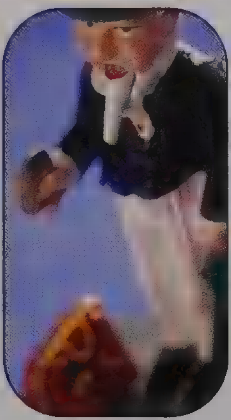

TAX PRACTICE CORNER

When Is Stock Worthless?

When an S corporation's stock becomes worthless, shareholders are treated as having disposed of their entire interest in the S corporation for passive activity loss purposes, allowing the shareholders to deduct suspended passive losses from the S corporation without regard to the passive activity loss rules. As demonstrated in *Bilthouse*, No. 05-c-4442 (N.D. Ill. 2007), aff'd, 553 F.3d 513 (7th Cir. 2009), taxpayers and the IRS frequently disagree on when the stock of a corporation becomes worthless.

Alan Bilthouse was a 25% shareholder in an S corporation, S&E Contractors Inc., a heavy construction contractor in Florida that performed public works projects. The company suffered large losses in 1994 and 1995. In 1995, the company became insolvent and defaulted on its construction bonds, and its bonding companies began collecting any subsequent revenues the company generated. S&E filed a lawsuit later that year against the city of Jacksonville, Fla., to try to recoup some of its financial losses from one of its projects with the city. The suit was settled in 1997, but S&E was denied any financial restitution.

In 2001, Bilthouse filed claims for refunds on personal amended returns for 1994 through 1999. Bilthouse contended that his S&E stock became worthless in 1997, resulting in a complete disposition of his interest in the stock per Sec. 165(g). By treating the disposition as occurring in 1997, under Sec 469(g), Bilthouse was able to deduct on the amended returns more than $5 million in accumulated disallowed passive losses that S&E had allocated to him over a number of years. The IRS argued that these claimed deductions were not allowable because Bilthouse's S&E stock became worthless in 1995, not in 1997. Bilthouse filed a refund suit, but the district court granted summary judgment for the IRS, and the Seventh Circuit affirmed.

Regs. Sec. 1.165-1(b) allows a taxpayer to deduct a loss that is evidenced by a closed and completed transaction, fixed by an identifiable event, and actually sustained in the tax year deducted. If stock is deemed worthless, the loss is deductible as of the last day of the corporation's tax year (Sec. 165(g)), and any suspended losses from a passive activity are released, since the entity is considered "disposed of" when its stock becomes worthless (Sec. 469(g)).

Even though Sec. 165(g) does not define "worthless," courts have determined when stock is worthless under various standards relating to the value of a company. In *Bilthouse*, the Seventh Circuit stated that whether stock was worthless is a facts-and-circumstances inquiry and that most courts look at both the liquidating value and the potential value in making the determination. If there is no liquidating value, the stock could still have potential value and will not be considered worthless if there is a reasonable hope that the company's assets will exceed its liabilities in the future. The *Bilthouse* court, citing *Keeney*, 116 F.2d 401 (2d Cir. 1940), determined that a reasonable hope is one that a reasonable investor, not an "incorrigible optimist," would have. Merely wishing or hoping that the company will do well in the future is not enough, and the taxpayer must provide objective evidence that the company has potential value.

The Seventh Circuit found that Bilthouse presented no objective evidence that it was reasonable to believe that the lawsuit against the city of Jacksonville would succeed and represented potential value for the company from 1995 until the lawsuit was settled in 1997. Rather, the evidence presented by the IRS showed that any potential value had essentially vanished when the company lost control over its rights to collect revenue. In combination with the bonding companies' no longer insuring its projects, the company had no way to earn revenue and bid on projects or control the allocation or collection of revenue. Therefore, in 1995, the company had no reasonable means of returning to solvency within the foreseeable future.

In most instances, it is better to take a loss in the earliest year possible, when the taxpayer can file a protective claim for refund. By waiting too long, the taxpayer may be barred by the statute of limitation. Another option a taxpayer may have is to sell the stock, even for a nominal amount, in an arm's-length transaction. However, this could result in a reduction of the overall loss. Regardless, this option will bypass the worthless security provisions of Sec. 165(g) and make the ensuing losses comply with Regs. Sec. 1.165-1(b). As always, taxpayers considering these alternatives should consult their tax adviser to make sure this is an appropriate strategy given their circumstances. ❖

*By **John W. McKinley**, CPA, CGMA, J.D., LL.M. (jwm336@cornell.edu), a lecturer at Cornell University and Ithaca College, and **Matthew Kimmey**, MBA (matthew.r.kimmey@us.pwc.com), a tax associate at PwC and a CPA candidate.*

To comment on this article or to suggest an idea for another article, contact Paul Bonner, senior editor, at pbonner@aicpa.org or 919-402-4434.

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MARITAL STATUS

ALL LEGAL SAME-SEX MARRIAGES RECOGNIZED FOR TAX PURPOSES

In the wake of the Supreme Court's *Windsor* decision (Sup. Ct. Dkt. No. 12-307 (6/26/13)), which invalidated a portion of the Defense of Marriage Act (DOMA), P.L. 104-199, the Treasury Department and IRS announced in late August that "same-sex couples, legally married in jurisdictions that recognize their marriages, will be treated as married for federal tax purposes." The IRS also issued a revenue ruling (Rev. Rul. 2013-17) and FAQs (tinyurl.com/ptg3u7q) providing guidance on the topic.

The ruling will apply to all federal tax provisions where marriage is a factor, for all federal taxes, including income, estate, and gift taxes. Tax provisions in which marriage is a factor include filing status, personal and dependency exemptions, the standard deduction, employee benefits, contributions to IRAs, the earned income tax credit, and the child tax credit, among others.

According to the IRS, more than 200 provisions in the Code and Treasury regulations include the terms "spouse," "marriage," "husband," "wife," or "husband and wife." Under the revenue ruling, the IRS will treat gender-neutral terms, such as "spouse" and "marriage," as including, respectively, an individual who is married to a person of the same sex if the couple is lawfully married under state law and such a marriage between same-sex individuals. The terms "husband," "wife," and "husband and wife" will be interpreted to include same-sex spouses.

The ruling will apply to taxpayers who are in any same-sex marriage legally entered into in one of the 50 states, the District of Columbia, a U.S. territory, or a foreign country. These marriages will be recognized for federal tax purposes, even if the state in which the couple currently resides does not recognize same-sex marriages. The IRS says this is consistent with its longstanding position (Rev. Rul. 58-66) that for federal tax purposes the IRS will recognize marriages based on the law of the state in which they were entered into and will disregard subsequent changes in domicile.

The ruling does not apply to taxpayers who are in registered domestic partnerships, civil unions, or similar formal relationships recognized under state law that do not have the status of legal marriage under state law. However, some states extend full community property treatment to such unions, for which the FAQs also provide guidance.

Under the ruling, legally married same-sex couples generally will file their 2013 federal income tax returns using either married filing jointly or married filing separately status. Such individuals may, but are not required to, file original or amended returns choosing to be treated as married for federal tax purposes for one or more prior tax years still open under the statute of limitation, if they were legally married during that tax year.

Treasury and the IRS also announced that they intended to issue streamlined procedures for employers who wish to file refund claims for payroll taxes paid on previously taxed health insurance and fringe benefits provided to same-sex spouses. They also said that they intended to issue further guidance on cafeteria plans and on how qualified retirement plans and other tax-favored arrangements should treat same-sex spouses for periods before the effective date of this revenue ruling.

The revenue ruling applies prospectively, effective Sept. 16, 2013, but taxpayers who wish to rely on it for earlier periods (for which the statute of limitation has not expired) may do so.

■ Rev. Rul. 2013-17

*By **Alistair M. Nevius**, J.D., the* JofA*'s editor-in-chief, tax.*

SELF-EMPLOYMENT TAX

GOVERNMENT FARM PAYMENTS SUBJECT TO SE TAX

The Tax Court held a taxpayer's net income from payments received under the U.S. Department of Agriculture's Conservation Reserve Program (CRP) was self-employment income under Sec. 1402(a).

During 2006 and 2007, Rollin Morehouse, a resident of Minnesota, received "CRP annual rental" payments as consideration for agreeing to set aside from crop growing and implement soil conservation practices on tracts of farmland owned in South Dakota. In filing his Forms 1040, Morehouse reported the payments for both years as rental income on Schedule E, *Supplemental Income and Loss*, and not as self-employment income on Schedule SE, *Self-Employment Tax*. The IRS assessed deficiencies for both years, determining that because the CRP payments were not farm rental income, they should have been reported on Schedule F, *Profit or Loss From Farming*, and on Schedule SE. The taxpayer petitioned the Tax Court, arguing self-employment tax did not apply because he never actually farmed in a customary manner before or during the CRP term and his participation was *de minimis*. Alternatively, he argued the payments were not self-employment income under the exclusion of Sec. 1402(a)(1) for certain rents from real estate and personal property leased with the real estate.

In ruling for the IRS, the court first

determined a trade or business existed because Morehouse's participation was regular, continuous, profit-motivated, and not *de minimis*, then determined payments received were subject to self-employment tax because the trade or business activities he performed were clearly related to the income received. Morehouse negotiated and obligated himself to terms of contracts, filed annual certifications, participated in emergency programs, and requested cost-sharing payments. Although he hired a third party to do planting and maintenance, he purchased seed and performed regular inspections. He also expanded his participation in the CRP over time, as he believed it was more profitable than leasing to farmers.

The court followed the Sixth Circuit's holding in *Wuebker*, 205 F.3d 897 (6th Cir. 2000) (which had reversed the Tax Court's holding in that case). In *Wuebker*, the appellate court held CRP payments were self-employment income and not eligible for the Sec. 1402(a)(1) exclusion. Because the government could access the real estate only for inspections, the rents received were for services performed by the landowner meeting the obligations of the contract rather than for the lessee's actual use of the real estate. In arriving at its decision, the Sixth Circuit found a link between the trade or business activities performed and income received. The Wuebkers engaged in farming before and during the contract term, performed the conservation practices on land owned and previously farmed, and used their own equipment in fulfilling their contractual obligations.

Similarly, the Tax Court determined that Morehouse was in the "business of participating in the CRP," that there was a clear connection between the trade or business activities he performed and the income received, and that the income did not qualify for the rental exclusion.

Morehouse was not eligible for the Sec. 1402(a)(1) self-employment tax exclusion for Social Security retirement or disability benefit recipients receiving CRP payments, because the payments were made before the 2008 effective date of the exclusion. The court reasoned that Congress had signaled its intent to not exclude all CRP payments from self-employment tax by enacting that exclusion.

Unless reversed upon appeal, the *Morehouse* decision means all individual and partnership landowners, regardless of their levels of participation, will more than likely be subject to self-employment tax on CRP income, unless the landowner qualifies for the rental real estate exclusion permitted for taxpayers receiving Social Security retirement or disability benefits.

■ *Morehouse*, 140 T.C. No. 16 (2013)

*By **Kim T. Mollberg**, CPA, CGMA, CMA, MBT, assistant professor, Minnesota State University Moorhead.*

ESTATE TAX

IS A REMITTANCE A DEPOSIT OR A PAYMENT?

A district court held that an estate's remittance to the IRS was a tax payment rather than a deposit. It denied the estate's refund request because it occurred after the three-year recovery period had expired.

Generally, a taxpayer must request a refund of a tax overpayment within three years from the date the return was filed or

Top 10 Manufacturing Sectors for R&D Credit

Manufacturing sector	Percentage of average annual gross receipts
1. Computers and electronic products	2.00%
2. Miscellaneous	1.38%
3. Chemicals	1.30%
4. Electrical equipment, appliances, and components	0.58%
5. Machinery	0.52%
6. Plastics and rubber	0.39%
7. Paper	0.31%
8. Printing and related support activities	0.24%
9. Fabricated metal products	0.23%
10. Textile and textile product mills	0.21%
All manufacturing	0.44%

Tax year 2010, including alternative simplified credit. Average annual gross receipts are for the four preceding tax years.

Among all industrial sectors, manufacturing ranked seventh in ratio of credit claimed to average annual gross receipts, behind mining (1.3%); real estate, rental, and leasing (0.9%); administrative/support and waste management services (0.7%); agriculture, forestry, fishing, and hunting (0.6%); professional, scientific, and technical services (0.5%); and information (0.5%).

Source: IRS Statistics of Income, Corporation Research Credit, Tables 1 and 2, at **tinyurl.com/cenyuuf**.

two years from the date the tax was paid, whichever occurs later. Sec. 6603 permits a taxpayer to make a deposit (not considered a tax payment) with the IRS to suspend interest on a potential underpayment of tax. A taxpayer can request the return of all or part of a deposit at any time before the deposit has been used by the IRS as payment of a tax. To be considered a deposit, a remittance must be accompanied by the taxpayer's written statement conforming to the requirements of Rev. Proc. 2005-18. In *Moran*, 63 F.3d 663 (7th Cir. 1995), when deciding whether a remittance was a deposit or a tax payment, the Seventh Circuit applied a facts-and-circumstances test by examining three factors: when the tax liability was determined, what the taxpayers intended, and how the IRS treated the remittance upon its receipt.

Marshall Syring, a resident of Superior, Wis., died on Oct. 14, 2005. The estate's accountant estimated a $650,000 estate tax liability, which he believed could be paid over 10 years. On July 14, 2006, the estate, based on its accountant's advice, remitted $170,000 to the IRS and requested an extension of its filing deadline to Jan. 14, 2007; however, no written statement conforming to Rev. Proc. 2005-18 was included with the remittance. The estate tax return, which reported no tax liability, was filed on Feb. 19, 2010. After an audit, the IRS determined an estate tax liability of $25,526, which the estate did not contest; however, it requested a refund of $144,474, the remainder of its remittance. The IRS denied the refund, arguing the remittance was a tax payment, not a deposit, and the estate's request for the refund of the tax payment was not timely. The estate filed suit in the U.S. District Court for the Western District of Wisconsin.

The court held the remittance was a tax payment, using the three-factor test of *Moran*. The court found that under the first factor, the facts indicated the payment was a deposit, since there was no formal tax assessment or a defined tax liability at the date of remittance. However, the court found the other two factors—taxpayer intent and the IRS's treatment of the remittance—indicated it was a tax payment. The estate would have had prima facie evidence that it intended to make a deposit if it had included a written statement outlined in Rev. Proc. 2005-18 with the remittance; however, the estate failed to do so.

> To be considered a deposit, a remittance must be accompanied by the taxpayer's written statement conforming to Rev. Proc. 2005-18.

The court looked at other factors to determine the estate's intent and concluded that three circumstances indicated that the estate intended to make a partial estate tax payment: (1) the careful estimate of the estate tax liability and the amount of the remittance by the estate's accountant; (2) the manner in which the accountant completed Form 4768, *Application for Extension of Time to File a Return and/or Pay U.S. Estate (and Generation-Skipping Transfer) Taxes*; and (3) the prompt action by the estate following the accountant's instructions.

Concerning the third *Moran* factor, the court found that the IRS treated the remittance as a payment since (1) Rev. Proc. 2005-18 states any remittance not accompanied by a written statement will be treated as a tax payment; (2) the IRS recorded the remittance as a "payment received"; and (3) it credited the payment to the estate's account rather than a separate deposit account. In its conclusion, the court stated, "This result may seem unfair—after all the government is allowed to keep a payment that it concedes was not due—but tax laws are 'not normally characterized by case-specific exemptions reflecting individualized equities' " (quoting *Brockamp*, 519 U.S. 347, 352 (1997)).

■ *Syring*, No. 12-cv-232-wmc (W.D. Wis. 8/15/13)

By ***Charles J. Reichert****, CPA, instructor of accounting, University of Minnesota–Duluth.*

HEALTH COVERAGE

FINAL RULES ISSUED ON INDIVIDUAL HEALTH CARE MANDATE

The IRS released final regulations on the Sec. 5000A shared-responsibility payment—the penalty or tax imposed on individual taxpayers who do not obtain minimum essential health care coverage beginning in 2014 (known as the "individual mandate").

The final rules adopt the proposed regulations issued in January with a few clarifications (REG-148500-12). They also cross-reference rules issued July 1 by the Department of Health and Human Services governing eligibility for and granting certain exemptions from the shared-responsibility payment, which include circumstances in which insurance exchanges will grant hardship exemptions from the requirement to obtain minimum essential health care coverage (78 *Fed. Reg.* 39494 (July 1, 2013)).

Under Sec. 5000A, starting next year, a taxpayer will be liable for the shared-responsibility payment if the taxpayer or any nonexempt individual whom the taxpayer may claim as a dependent for a tax year does not have minimum essential coverage in a month included in that tax year. Married taxpayers filing a joint return are jointly liable for the payment.

The regulations cover:

- ***Maintenance of minimum essential coverage and liability for the shared-responsibility payment.*** Regs. Sec. 1.5000A-1 defines minimum essential coverage and liability for the shared-responsibility payment, including for dependents.
- ***Minimum essential coverage.*** Regs. Sec. 1.5000A-2 defines the different types of health plans that qualify as minimum essential coverage.
- ***Exempt individuals.*** Regs. Sec.

1.5000A-3 defines who is exempt from the payment.

- ***Computation of the shared-responsibility payment.*** Regs. Sec. 1.5000A-4 contains rules for computing the amount of the payment.
- ***Administration and procedure.*** Regs. Sec. 1.5000A-5 states when the payment is due, that liens or levies to collect the payment are prohibited, that the taxpayer is not subject to criminal penalties for nonpayment, and that the IRS has authority to offset overpayments of tax to collect the payment.

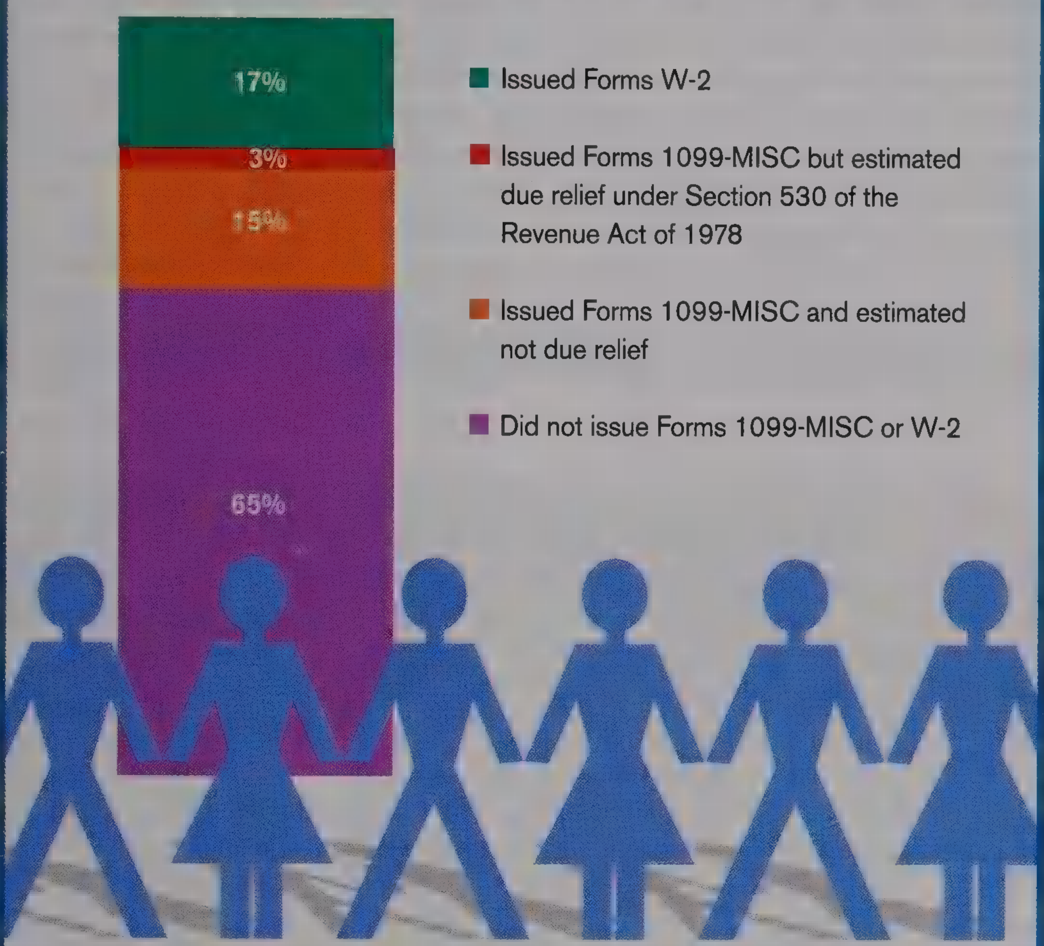
Minimum essential coverage is coverage under a government-sponsored program (Medicare, Medicaid, Tricare, the Children's Health Insurance Program, etc.); an eligible employer-sponsored plan (defined in Regs. Sec. 1.5000A-2(c)); a plan in the individual market (generally, insurance through a health care exchange); a health plan grandfathered under the health care acts (the Patient Protection and Affordable Care Act (PPACA), P.L. 111-148, and the Health Care and Education Reconciliation Act, P.L. 111-152); or other health benefits coverage that has been recognized as minimum essential coverage by the secretary of Health and Human Services (Regs. Sec. 1.5000A-2).

Exempt individuals include:

- Members of a religious sect whose members oppose government insurance benefits (Regs. Sec. 1.5000A-3(a));
- Members of health care sharing ministries, which are groups that share a common set of ethical or religious beliefs and share medical expenses among themselves (Regs. Sec. 1.5000A-3(b));
- Exempt noncitizens, meaning noncitizens, nonresident aliens, and people who are unlawfully present in the United States (Regs. Sec. 1.5000A-3(c));
- People in jail (Regs. Sec. 1.5000A-3(d));
- An individual who lacks affordable coverage (meaning the individual's required contribution for minimum essential coverage exceeds 8% of the individual's household income) (Regs. Sec. 1.5000A-3(e));
- Individuals whose household income is below the filing threshold in Sec. 6012(a)(1) (Regs. Sec. 1.5000A-3(f));
- Members of Indian tribes (Regs. Sec. 1.5000A-3(g));
- Individuals who obtain a hardship exemption certificate certifying that they have suffered a hardship that prevents them from obtaining coverage (Regs. Sec. 1.5000A-3(h)); and
- Individuals who were without coverage for less than three consecutive months (Regs. Sec. 1.5000A-3(j)).

The final regulations were changed from the proposed rules to clarify that medical coverage offered to employees by an organization acting on an employer's behalf qualifies as an employer-sponsored plan. The final rules also added the Nonappropriated Fund Health Benefits Program offered by the Defense Department to the definition of government-sponsored plans that qualify for minimum essential coverage, and Treasury is considering

Employee Determinations Not Always Followed



Of a sample of 5,067 employers for which the IRS determined employee status on a filing in 2009 of Form SS-8, *Determination of Worker Status for Purposes of Federal Employment Taxes and Income Tax Withholding*, only 17% subsequently issued Forms W-2 for the workers. Eighty percent either continued issuing Form 1099-MISC, *Miscellaneous Income*, (and were estimated not due relief under Section 530 of the Revenue Act of 1978) or subsequently issued neither form (which could mean the person was no longer employed).

Source: Treasury Inspector General for Tax Administration, *Employers Do Not Always Follow Internal Revenue Service Worker Determination Rulings*, Rep't No. 2013-30-058, available at **tinyurl.com/mkdrp2r**.

PHOTO BY HEMERA/THINKSTOCK

whether other government programs might qualify. And the final regulations clarify that a self-insured health plan is an eligible employer-sponsored plan, regardless of whether it could be offered in a large or small group market in a state.

Generally, a plan in the individual market includes health plans offered through an exchange in a state. Section 1304(d) of the PPACA and the final regulations provide that the term "state" means each of the 50 states or the District of Columbia. However, the PPACA permits territories of the United States to create exchanges. Accordingly, the final regulations provide that a qualified health plan offered through an exchange in a U.S. territory meets the definition of a plan in the individual market within a state.

The regulations apply to months beginning after Dec. 31, 2013, when the Sec. 5000A penalty first applies.

In 2012, the U.S. Supreme Court upheld the individual mandate as a permissible exercise of Congress's taxing powers under the Constitution (*National Federation of Independent Business v. Sebelius*, Sup. Ct. Dkt. No. 11-393 (U.S. 6/28/12)).

■ T.D. 9632

By ***Sally P. Schreiber****, J.D., a* JofA *senior editor.*

HEALTH COVERAGE

PROPOSED RULES ISSUED FOR SMALL EMPLOYER HEALTH INSURANCE PREMIUM CREDIT

The IRS issued proposed regulations governing the Sec. 45R credit for small employers that offer health insurance coverage for employees (REG-113792-13). The proposed rules incorporate the provisions of Notices 2010-44 and 2010-82, modified to reflect the statutory changes starting in 2014, notably, a higher credit amount, the fact that employers must obtain the insurance coverage through an exchange, and a two-year limit on taking the credit.

Sec. 45R was added by the Patient Protection and Affordable Care Act, P.L. 111-148. From 2010 to 2013, small businesses—defined as businesses with 25 or fewer employees and average annual wages of less than $50,000—have been eligible for credits of up to 35% of nonelective contributions the businesses make on behalf of their employees for insurance premiums. Tax-exempt organizations have been eligible for a 25% credit against payroll taxes. Beginning in 2014, the maximum credit increases to 50% (and 35% for tax-exempt organizations).

The credit amount is based on a percentage of the lesser of: (1) the amount of nonelective contributions paid by the eligible small employer on behalf of employees under a qualifying arrangement during the tax year, and (2) the amount of nonelective contributions the employer would have paid under the arrangement if each employee were enrolled in a plan that had a premium equal to the average premium for the small group market in the rating area in which the employee enrolls for coverage.

The proposed rules provide that employers that are exempt from tax under Sec. 501(a) but not described in Sec. 501(c) are not eligible for the credit, but a Sec. 521 farmers' cooperative that is subject to tax under Sec. 1381 is eligible for the credit as a taxable employer (as long as it meets the other eligibility requirements).

The regulations incorporate the rule that the credit does not require the employees to be performing services in a trade or business. An employer who otherwise meets the eligibility requirements can take the credit for employees who are not performing services in a trade or business, such as a household employee. Eligible small employers located outside the United States that have income effectively connected with the conduct of a trade or business in the United States may claim the credit only if the employer pays premiums for health insurance coverage issued in and regulated by one of the 50 states or Washington, D.C.

Under Sec. 45R, sole proprietors, partners in a partnership, shareholders owning more than 2% of the stock in an S corporation, and any owners of more than 5% of other businesses—and their family members—are not taken into account as employees for purposes of the credit. Although Sec. 45R does not specifically refer to spouses, the IRS says that spouses are nevertheless excluded from the definition of employee for those purposes.

In a "qualifying arrangement," the employer pays a uniform percentage (not less than 50%) of the premium cost for each employee enrolled in health insurance coverage. If an employer is entitled to a state tax credit or a premium subsidy that is paid directly to the employer, this amount is not included in determining whether the employer has satisfied the premium payment requirement. It is taken into account in calculating the credit, however.

For 2014 and later, employers must obtain health insurance through a Small Business Health Options Program (SHOP) exchange, which is an insurance exchange specifically set up for small businesses to obtain coverage. Before 2014, there was no time limit on taking the credit, so employers that qualified could have taken it in 2010 through 2013. Beginning in 2014, a two-year limit begins with the first year (after 2013) the employer files Form 8941, *Credit for Small Employer Health Insurance Premiums*. However, if an entity's predecessor entity (as determined under employment tax rules) claimed the credit, that predecessor's period will count toward the successor entity's two-year credit period.

The proposed regulations also provide a transitional rule for employers with non-calendar-year insurance plans.

The regulations will be effective the date they are published as final in the *Federal Register*, but taxpayers may rely on them for tax years beginning after 2013 and before Dec. 31, 2014.

■ REG-113792-13

By ***Sally P. Schreiber****, J.D., a* JofA *senior editor.*

Tax Matters editor Paul Bonner can be reached at pbonner@aicpa.org or 919-402-4434.

Line Items

REVENUE PROCEDURE PROVIDES LIBERAL RELIEF FOR LATE S CORP. ELECTIONS

The IRS consolidated in Rev. Proc. 2013-30 provisions of a number of previous revenue procedures for requesting relief for late elections relating to S corporations. These include S elections under Sec. 1362, qualified subchapter S trust (QSST) elections, electing small business trust (ESBT) elections, qualified subchapter S subsidiary (QSub) elections, and corporate classification elections. The new procedure is now the exclusive simplified method for taxpayers to apply for relief for these late elections.

In general, the revenue procedure expands the time for requesting relief for these late elections to three years plus 75 days after the date the election was intended to be effective. However, for a simple late S election request, if certain requirements are met, there is no deadline for requesting relief. Taxpayers that do not qualify for this simplified relief must submit a request for a letter ruling and pay a user fee.

The revenue procedure contains general requirements for all the elections within its scope as well as specific requirements for each type of election. Among the general requirements is that the requesting entity must file a reasonable cause/inadvertence statement that is signed under penalties of perjury describing its reasonable cause for failing to timely file the S election on Form 2553, *Election by a Small Business Corporation*, or QSub election on Form 8869, *Qualified Subchapter S Subsidiary Election*, or stating that the failure to file the QSST or ESBT election was inadvertent, and describing its diligence in correcting the errors after they were discovered. These statements must be attached to the applicable election form, which must contain the statement "Filed pursuant to Rev. Proc. 2013-30" at the top.

> Rev. Proc. 2013-30 is now the exclusive simplified method for taxpayers to apply for relief from late S corporation elections.

Under the new procedure, an S corporation that meets all the following requirements is not subject to the three-year, 75-day deadline, but instead has no time limit on requesting relief if:

- It is not seeking a late corporate entity classification election;
- It fails to qualify as an S corporation

solely because Form 2553 was not timely filed;

- It and all of its shareholders reported their income consistent with S corporation status for the year the election should have been made and all later years;
- At least six months have passed since the corporation filed its first S corporation year tax return;
- The IRS did not notify the corporation and the shareholders of any problem with the S corporation status within six months after the return was filed; and
- The completed election form includes statements from all shareholders from the date the election was to have been effective to the date of the filing, stating that they have reported their income consistent with S corporation status.

The new rules are effective for requests received on or after Sept. 3, or that were pending on that date.

REVENUE PROCEDURE ADDRESSES INNOCENT SPOUSE ABUSE, STREAMLINED APPLICATIONS

The IRS issued Rev. Proc. 2013-34, providing rules under which taxpayers can obtain equitable innocent spouse relief from joint liability under Sec. 66(c) or 6015(f).

The revenue procedure adopts the procedures proposed in Notice 2012-8 with a few changes, notably, (1) a "streamlined" procedure under which, in appropriate cases, the IRS will grant relief, (2) a much broader view of how a requesting spouse's being subjected to financial control or abuse affects the various prerequisites for relief, and (3) the availability of refunds in certain cases.

> Rev. Proc. 2013-34 contains a "streamlined" procedure for relief and a broader view of the effect of financial control or abuse on requests for relief.

Streamlined procedures. Streamlined determinations are available for requesting spouses who meet the initial requirements for equitable relief and (1) are no longer married, (2) would suffer economic hardship if relief is not granted, and (3) for Sec. 6015(f) relief, did not know or have reason to know of the understatement or deficiency or the underpayment of tax, or, for Sec. 66(c) relief, did not know or have reason to know of an item of community property income properly treated as gross income that would be treated as the income of the nonrequesting spouse.

If the nonrequesting spouse maintained control of the finances and restricted the requesting spouse's access or abused the spouse so that the requesting spouse was not able to challenge the treatment of any items, the requesting spouse will satisfy the third requirement whether or not he or she was aware of the item. (When abuse rises to the level that a spouse signed the joint return under duress, the IRS has always taken the position and takes the position in this revenue procedure that equitable relief is not necessary because no joint return was filed.)

If the requesting spouse is not eligible for a streamlined determination, the spouse is still eligible to be considered for equitable relief under the normal procedures.

Abuse or financial control. The revenue procedure also gives greater deference to the presence of abuse than prior guidance did. For example, if the nonrequesting spouse abused the requesting spouse or maintained control over the household finances by restricting the requesting spouse's access to financial information, and, because of the abuse or financial control, the requesting spouse was not able to challenge the treatment of any items on the joint return for fear of the nonrequesting spouse's retaliation, then that abuse or financial control will result in this factor weighing in favor of relief even if the requesting spouse knew or had reason to know of the items giving rise to the understatement or deficiency. Under the prior rules of Rev. Proc. 2003-61, a requesting spouse's knowledge of an item was a strong factor weighing against relief.

> Rev. Proc. 2013-34 elaborates on the position that an innocent spouse is not required to request equitable relief within two years after the IRS began collection activities.

Refunds. Refunds may be paid in both understatement and underpayment cases if the requesting spouse provided the funds used and the payments were made after July 22, 1998 (the date the most recent statutory version of innocent spouse relief was enacted), the revenue procedure also provides. Under Rev. Proc. 2003-61, refunds were available only from funds paid by the requesting spouse under an installment agreement.

Statute of limitation. The revenue procedure elaborates on the IRS's current position, also addressed in proposed regulations (REG-132251-11) and announced in Notice 2011-70, that for requests for relief under Sec. 6015(f) or 66(c) filed on or after July 25, 2011, a spouse is not required to request relief within two years of the date the IRS began collection activities. Equitable relief must now be requested within 10 years after the tax at issue was originally assessed or, if a claim for refund is involved, within the later of the three-year period since the return was filed or the two-year period in which the tax was paid.

Effective date. Rev. Proc. 2013-34 supersedes Rev. Proc. 2003-61 and is effective for requests pending on or after Sept. 13, but also can be applied to cases pending on that date, whether with the IRS, in the IRS Appeals office, or in court. ❖

TAX ACCOUNTING METHODS

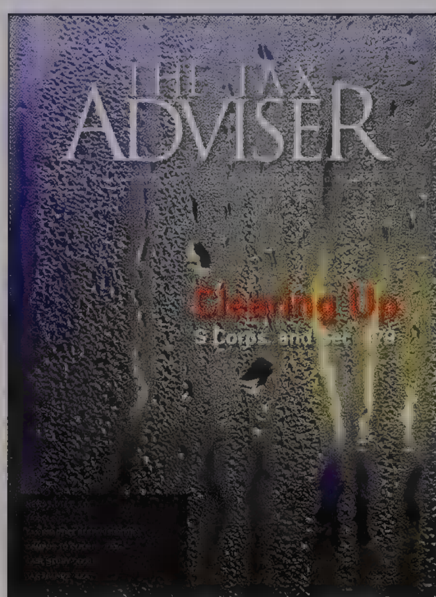
New Guidance on Gift Cards and Deferral of Income

Gift cards and gift certificates have an appealing feature that makes them desirable to both givers and receivers—convenience. Nowadays, many gift cards are not limited to a specific retailer; some gift cards are accepted by multiple merchants. Under prior law and guidance, revenue from gift card sales was recognized in the tax year of receipt; however, under regulations as modified and clarified by a series of revenue procedures, such revenue may be deferred in certain situations.

On July 24, 2013, the IRS issued Rev. Proc. 2013-29, which allows taxpayers to defer income from the sale of gift cards or gift certificates redeemable by an unrelated entity until the cards or certificates are redeemed for goods and services by that entity. This modification is effective for tax years ending on or after Dec. 31, 2010.

For tax purposes, gift card and gift certificate sales are viewed as advance payments for goods and services. Rev. Proc. 2011-18 allows taxpayers to use the deferral method for eligible gift card sales that are redeemable by another entity. For the gift card sale to be eligible for the deferral method, the taxpayer must be primarily liable for the card's value until it is fully redeemed or reaches expiration. The gift card must also be redeemable by the taxpayer or another entity legally obligated to accept it as payment for goods and services.

Revenue recognition becomes more complicated when an unrelated taxpayer may also redeem a gift card's value. An unrelated entity is an entity whose financial statements are not consolidated with the taxpayer's applicable financial statement (Rev. Proc. 2013-29, §2.04). If the gift card is redeemed by an unrelated entity, the revenue is earned and recognized by the unrelated entity upon the sale of goods or services. Under these revenue deferral provisions, there may be times when the taxpayer may not recognize income in its financial statements from the sale of gift cards redeemed by an unrelated entity.



thetaxadviser.com

Accordingly, Rev. Proc. 2013-29 modifies and clarifies the existing rules promulgated under Rev. Proc. 2011-18 to provide that for gift card sales redeemable by an unrelated entity, sales are earned and recognized as revenue in the taxpayer's applicable financial statement when the gift card is redeemed. Taxpayers without applicable financial statements earn revenues to the extent the gift card is redeemed by the entity during the tax year. However, gift card sales redeemable by the taxpayer or related entities are still subject to a maximum one-year deferral.

For a detailed discussion of the issues in this area, see "Deferral of Income From Sales of Gift Cards," by Maribeth Quilao, CPA, in the November 2013 issue of *The Tax Adviser*.

—*Alistair M. Nevius, editor-in-chief*
The Tax Adviser

Also look for articles on the following topics in the November 2013 issue of *The Tax Adviser*:

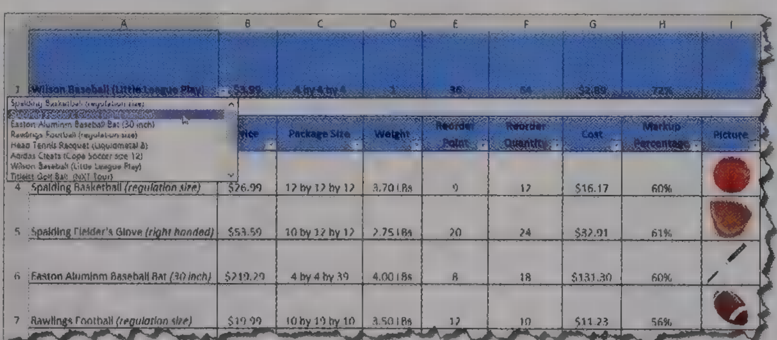
- The application of the Sec. 179 limitation to S corporations in a controlled group.
- The IRS's oversight of valuation professionals.
- Issues involved with treating partners as employees.

Technology Q&A

by J. Carlton Collins, CPA

POP-UP IMAGES IN EXCEL

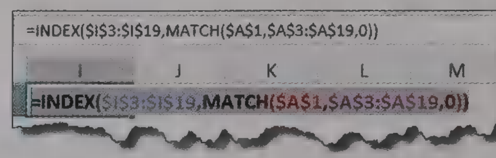
Q Our company sells more than 4,000 sporting good items, and to help analyze these items, we export a list from our accounting system into Excel. The list includes size, weight, reorder point, reorder quantity, cost markup percentage, pricing, and images. To make individual items easier to work with, my workbook has a dropdown list and several formulas that repeat the data for any given inventory item at the top of the worksheet (in row 1) based on the item I select in cell A1. For example, the screenshot below shows line item data in row 5 repeated in row 1, which makes it easier to focus on this single item to analyze its details. The problem is I want the item image to also be repeated on row 1 (because the picture helps me differentiate between similar items), but I don't know if this can be done.



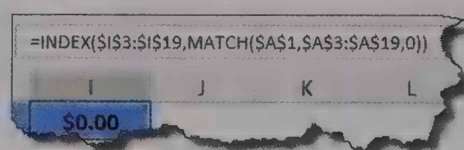
Specifically, when the inventory item "Spalding Fielder's Glove" (shown in row 5 in this example) is selected from the dropdown list in cell A1, I want the picture image of the glove to also appear in cell I1. Is this possible, and if so, how?

A The solution you seek is indeed possible, but be forewarned that the procedures are advanced, so don your thinking cap. In essence, you want to create a new formula that is virtually identical to the ones you have already created in row 1, but instead of entering this new formula into cell I1, you need to enter it into Excel's Name Manager, where the formula can be assigned a specific name. Next, you want to insert an image into cell I1, and then tag that image with the new formula created in Name Manager. The following steps explain this process in detail.

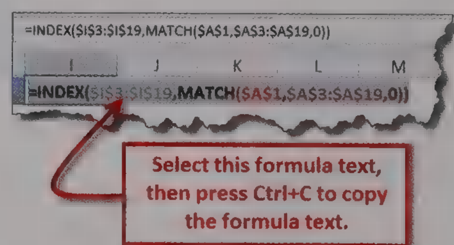
1. *Copy your formula to cell I1.* You've already done a good job of creating the proper formulas (using the INDEX and MATCH functions as pictured in the screenshot near the top of the next column) in cells B1 through H1 to repeat an inventory item's data on row 1. Next, copy the formula you have already created in cell H1 and paste it to cell I1, then edit the formula to make all of the cell references absolute, by inserting dollar signs where needed. The result in cell I1 should appear as follows:



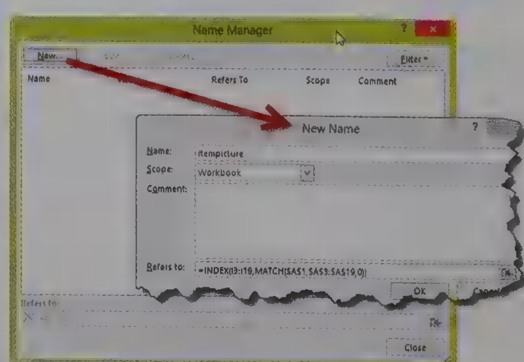
Note: The resulting formula in cell I1 will produce a zero result. This is normal and expected. (The reason for copying and pasting this formula into cell I1 is to more easily create the final formula with the proper cell references that you will need to paste into Name Manager in step 3 below. Eventually, you will delete this formula from cell I1, in step 4 below.)



2. *Copy the formula text from cell I1.* Select cell I1 and press the F2 key to enter Edit Mode. Select (or highlight) the formula text and press Ctrl+C to copy the formula text, then press ESC to exit Edit Mode.

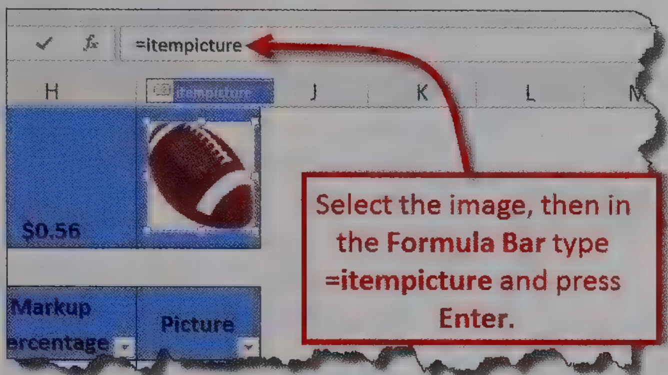


3. *Create a new formula in Name Manager.* From the **Formulas** tab, select **Name Manager**, and in the **Name Manager** dialog box, click **New**. (*Tip:* At this point it will be helpful to drag



the **New Name** dialog box wider so you can better see the formula you are creating.) In the **New Name** dialog box enter the phrase itempicture in the **Name** box (see screenshot at end of previous page), paste the formula you copied from cell I1 in the previous step into the **Refers to** box, and then click **OK**.

4. ***Clean up.*** Make row 1 taller so the resulting item image fits. Also, erase the formula you previously entered into cell I1 because it is no longer needed.
5. ***Insert picture and affix a tag.*** Insert (or copy and paste) any picture into cell I1 and then resize and reposition the picture so it fits within the borders of cell I1. Click on the picture in cell I1 to select it, then in Excel's **Formula Bar** enter the phrase =itempicture and press the Enter key. (This process will affix a tag to the image linking it to the new formula created using Name Manager.)

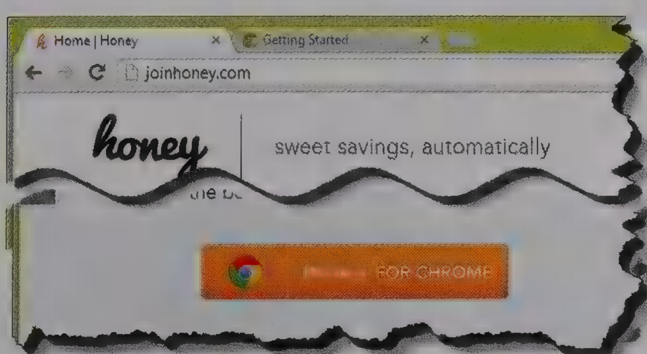


Thereafter, the image in cell I1 will change to reflect the inventory item selected in cell A1. This particular application of Name Manager may seem foreign to you, but once created, its use is simple and the results are compelling. You can download an Excel workbook containing this solution at carltoncollins.com/picture.xlsx.

SWEET SAVINGS

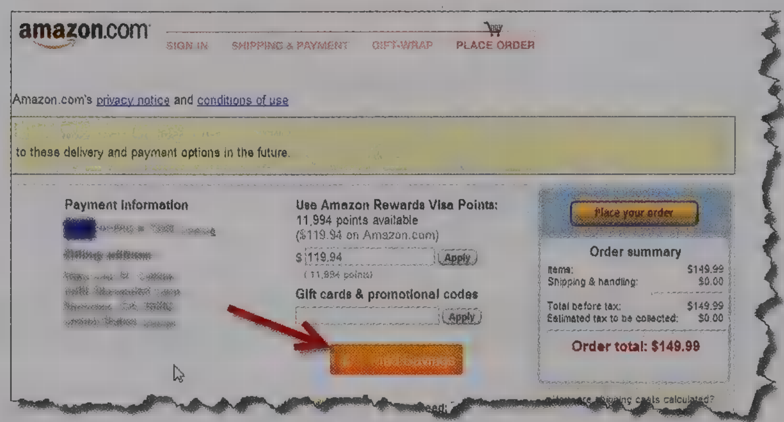
Q When I purchase merchandise on the web, I often see an option to enter a discount code on the checkout page, but I never seem to have one. I've tried searching the web for discount codes that I might use, but I never seem to find codes related to my purchase. Is there a website that maintains a list of current discount codes that might be usable?

A I, too, have found that searching for purchase discount codes rarely yields satisfactory results, but I do have one recommendation worth trying. A free website called Honey requires

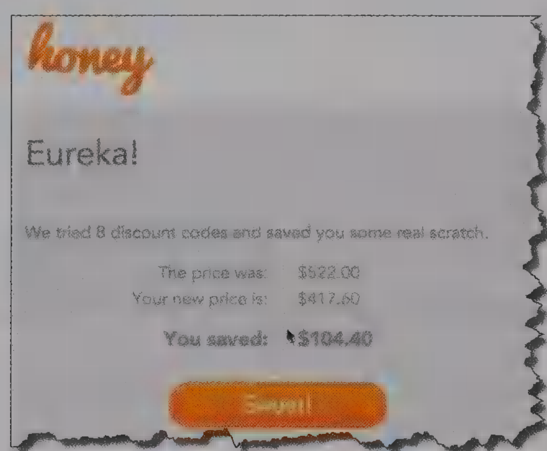


no personal information and maintains a large database of up-to-date discount codes. (***Note:*** This solution only works with the Google Chrome and Firefox browsers.) To use this solution, launch Google Chrome or Firefox (if you do not have Google Chrome or Firefox installed, you can download and install them at tinyurl.com/7st238h or tinyurl.com/3ck8ycb, respectively), visit joinhoney.com, and then click either the **Install for Chrome** or **Install for Firefox** button, as shown in the previous column.

Thereafter, shop as you normally would, and when you check out, click the Honey **Find Savings** button to initiate a search of available discount codes. If savings are found, Honey will enter the code automatically.



Honey continuously monitors the web for new promotions and coupon codes, and harvests codes that have been successfully used by others. In addition, several hundred online retailers provide discount codes to Honey—including Amazon, Banana Republic, Best Buy, Gap, Home Depot, Kohl's, Macy's, Old Navy, Sears, Target, Walgreens, and others. This solution does not always yield discounts, but I have saved from 10% to 30% on several occasions.



THE LOWDOWN ON UTILITY DOWNLOADS

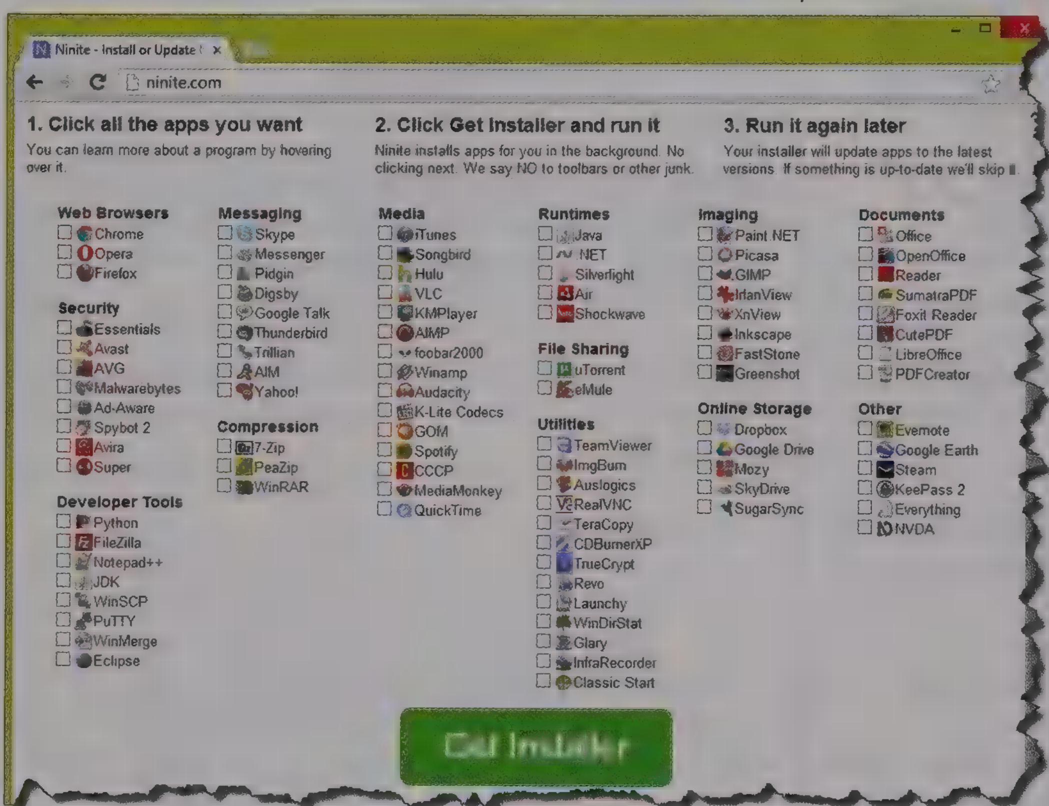
Q I recently purchased a new computer and proceeded to download various utility programs. To my dismay, I found numerous download websites offering the utilities I wanted, but I couldn't tell which ones were trustworthy. As a result, twice I ended up unintentionally downloading malware along with the intended utility programs. It seems that today, many malicious

websites provide downloads of legitimate software programs secretly bundled with malicious malware. How can I tell which utility download websites are legitimate?

A Try downloading your utilities free from ninite.com. Ninite is an established one-stop website that provides downloads for dozens of popular utilities, including Acrobat Reader, Ad-Aware, Chrome, Classic Start, Dropbox, Evernote, Hulu, iTunes, Java, keyPass2, Paint, QuickTime, Silverlight, Skype, Thunderbird, TrueCrypt, uTorrent, WinRAR, and more. In addition, Ninite provides the following benefits:

- Allows you to install all of your utilities at once;
- Automatically installs apps and utilities to their default locations;
- Automatically declines installing extra toolbars, menus, or junk;
- Automatically installs 64-bit apps on 64-bit machines;
- Performs installations in the background; and
- Always installs the latest stable versions.

In addition, running Ninite again later will automatically update your utilities.



To use Ninite, visit Ninite.com (pictured above), check the boxes next to the utilities you want to install, then click the **Get Installer** button; the installations will be performed in the background.

As an option, for $9.95 a year, Ninite monitors and updates your utilities and apps automatically. In addition, Ninite Pro (priced starting at $20 per month) provides the ability to install utilities and apps remotely, manage multiple PCs from a central location, turn off annoying notifications (such as "Java Update Available"), customize installation schedules, and more.

SKIP THE YOUTUBE COMMERCIALS

Q I view YouTube and other online videos frequently, but the growing number of commercials I am forced to watch before each YouTube clip plays is maddening. Is there any way to disable those commercials?

A A free plugin called Adblock Plus automatically blocks YouTube's video ads. This solution works with Android, Chrome, Firefox, Internet Explorer, and Opera browsers. To install Adblock Plus, visit tinyurl.com/4hxov8w and click the **Install for Chrome** button (assuming you use Chrome). Thereafter, when played, your YouTube clips will skip any advertising videos inserted at the beginning of the clip. Many other ad-blocking solutions are designed to suppress all advertisements, even the benign ads located in the edges of the screen. Such solutions can be counterproductive because those ads may be of interest to you and they financially help keep the website up and running. Adblock Plus focuses on blocking only the so-called annoying ads, such as those 30-second video commercials often found preceding popular YouTube videos. It is worth noting that Adblock Plus can also block domains known to be infected by malware, remove Facebook **Like** buttons that can track your browsing habits, and disable ad tracking for hundreds of ad companies for more private web browsing.

WHAT'S NEXT?

Q For three decades I've watched new technologies emerge, but I've never invested early enough to catch those investments on the rise. What do you think the next great emerging technologies will be?

A Asking me for investment tips is like asking a dog to guard your hamburger—in either case chances are you won't be satisfied with the result. Nonetheless, I like talking about technology, so I'm willing to make a few predictions. Off the top of my head, I believe that 3-D printing, RFID shopping, or smart glass will make a splash in the decade to come. Here's a brief explanation of these three technologies.

3-D printing. Technology that enables you to print solid objects has arrived. The technology is fairly straightforward. You already know that your current laser printer lays down ordinary toner on paper thick enough to feel with your fingertips. 3-D printers simply do the same thing, printing hundreds (or even thousands) of layers atop one another using a special toner containing composite material similar (in results) to the compound your dentist uses to fill cavities. Once hardened, the resulting printed object is very durable, and can even include moving parts.

For example, the adjustable wrench pictured below was printed using a 3-D printer and is fully functional.

Already, 3-D printers are available for less than $400, and the potential implications are tremendous. In the future, 3-D printers may be as commonplace as microwave ovens. For example, instead of ordering a replacement part needed to repair your luggage, appliance, or automobile, you may simply print that part instead. In the future, electronic product manuals may include schematics for 3-D printing (replicating) the necessary replacement parts. Hospitals are already using 3-D printers to create skeletal body parts to repair the human skull, jaw, limbs, etc. 3-D printing also has the potential to reduce (or someday eliminate) the need to ship goods and parts around the world, or simply from one town to the next. You can view a video clip of a 3-D printed object at tinyurl.com/obtgty2.

RFID shopping. RFID (radio-frequency identification) tags work very much like a bar code, except they emit an electronic signal that can be read at a distance, and these signals can contain far more information and can be read quickly in large quantities. RFID technology is already a proven technology. For example, for more than two decades Atlanta drivers have installed RFID tags in their automobiles, enabling them to pay tolls on the Georgia 400 highway without stopping or even slowing down. As the automobile speeds through the toll booth, a specific radio signal emitted from the toll booth temporarily supplies energy to and activates the automobile's RFID tag so the user's account can be determined and the proper toll collected.

The use of RFID tags is becoming more prevalent. I believe that within the next decade we will see RFID tags affixed to virtually every retail product. Shoppers will enter a retail store, select their merchandise, and then simply walk out the front door, while in the background, RFID technology identifies the shopper and his or her merchandise selections, and automatically deducts the required payment from the shopper's account. To prevent identity theft, it is likely that to complete the sales transaction, each shopper will be required to enter a password or provide identification, such as a fingerprint, ID card, or retina scan, to verify his or her identity.

The use of RFIDs offers many benefits. For example, their use can reduce (or eliminate) the need for labor-intensive scanners to read bar codes one at a time, while also reducing (or eliminating) the need to purchase and recharge hand-held bar code readers. A video clip produced by IBM demonstrates this type of technology in action at tinyurl.com/qbdv3sx. RFID technology has been used at the pallet level for more than a decade by more than 80,000 manufacturers and suppliers, and I predict that it is only a matter of time before RFID tags become affordable enough to deploy at the item level as well.

The implications of RFID technology are impressive. Imagine never waiting in line at the grocery store again. Imagine a grocery store's savings if it could eliminate the majority of its cash registers, cashiers, and checkout area floor space. Imagine the impact on retail prices if this potential savings were passed on to consumers. I foresee a day when we will run out to buy milk and bread, and we will face the decision to shop at either a traditional grocery store or one with no waiting and lower prices; this would be an easy decision, right? I suspect that the retailers who implement this technology first will likely grow their customer base very quickly.

Smart glass. Smart glass technology, such as that provided by Samsung's Smart Window, is basically a computer monitor that looks like a regular window when it's not in use. However, a simple tap of the glass activates the device, effectively transforming the glass into a touch-screen computer.

How might this technology be used? Imagine your car windshield displaying turn-by-turn driving directions that correspond exactly with your view beyond the windshield. Imagine your bathroom mirror waking up to your touch and delivering news and stock information as you brush your teeth. Imagine a large glass wall in a hotel lobby that activates at your touch to provide an informative concierge and information portal. You can view a short video showcasing smart glass technology at tinyurl.com/86xkzlr.

Admittedly, applications of smart glass thus far lean more toward "cool novelty" than "useful technology," but history has taught us that many new technologies are often under-appreciated at first, only to become mainstream solutions down the road. For example, the controversial peer-to-peer solution Napster ultimately morphed into the well-received Skype solution. ❖

J. Carlton Collins (carlton@asaresearch.com) is a technology consultant, CPE instructor, and JofA *contributing editor.*

Note: *Instructions for Microsoft Office in "Technology Q&A" refer to the 2013, 2010, and 2007 versions, unless otherwise specified.*

Submit a question

Do you have technology questions for this column? Or, after reading an answer, do you have a better solution? Send them to jofatech@aicpa.org. We regret being unable to individually answer all submitted questions.


ScanSnap
I audit
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Inside AICPA

MEDAL OF INSPIRATION CELEBRATES STUDENT'S SUCCESS IN FACE OF ADVERSITY

Andrey A. Stoyan, a 2013 San Diego State University accounting graduate, received the Medal of Inspiration Award from Beta Alpha Psi (BAP), an honors organization for financial information and accounting students and professionals.

The award, sponsored by the AICPA, is given to a student who has experienced extreme hardships and who has demonstrated an unusually high level of success despite that adversity. The award includes a $5,000 cash stipend.

Andrey A. Stoyan

Stoyan emigrated from Russia in 2008 to escape social intolerance and oppressive discrimination. At the time, he knew a limited amount of English and only had $1,000 to his name.

Stoyan was granted asylum in the United States, but he still faced many obstacles trying to obtain an education without a high school diploma or GED, and he was unable to transfer his Russian transcripts to SDSU.

However, after two years at a community college, he was accepted into SDSU, where he was elected vice president of professional development in the university's BAP chapter. He has also interned for KPMG and performed volunteer work on campus and in the community, in addition to working 20–30 hours per week.

Stoyan is expected to become a full-time audit accountant with BDO and apply for U.S. citizenship this fall.

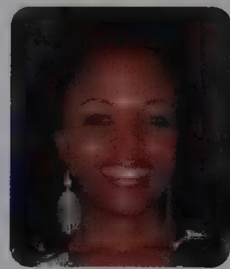
INSTITUTE RECOGNIZES OUTSTANDING CPAs IN GOVERNMENT

Marcia Buchanan, of Washington, received the Institute's Outstanding CPA in Government Career Contribution Award. The award—which replaces the previous Outstanding CPA in Government Award—recognizes the significant contributions to the efficiency, effectiveness, or innovative service delivery of the government entities for which she has worked.

Buchanan recently retired as assistant director of government auditing standards on the U.S. Government Accountability Office's (GAO's) Financial Management and Assurance Team. She was responsible for maintaining, interpreting, and promoting *Government Auditing Standards*, commonly known as the "Yellow Book," and served as a staff aide to the Advisory Council on Government Auditing Standards. During her almost 40 years with the GAO, she gained extensive experience on issues such as financial audits, performance audits, audit quality, and single audits.

Marcia Buchanan

Also Jennifer Coleman, of New Orleans; Pamela Leary, of Juneau, Alaska; and Alfredo Riverol, of Miami, received the inaugural Outstanding CPA in Government Impact Awards.



Jennifer Coleman

The awards recognize CPAs working in federal, state, and local government who have contributed significantly to the increased efficiency and effectiveness of government organizations and to the growth and enhancement of the CPA. These awards focus on current or recent (within the last three to five years) accomplishments.

Pamela Leary

Coleman, who received the federal award, is the lead accountant/CPA at the U.S. Department of Energy. With 29 years of government services experience, she has held accounting roles in the U.S. Army Corps of Engineers, the IRS, and the U.S. Department of Agriculture. For more than 13 years, she has been facilitating college accounting classes and government training seminars to work with the accounting community and to keep up with government and accounting trends.

Alfredo Riverol

Leary, who received the state award, is the comptroller for the state of Alaska's Department of Revenue, Treasury Division, and the deputy treasurer of the Alaska Municipal Bond Bank. She began her career as an auditor with Price Waterhouse and became a partner in the firm PricewaterhouseCoopers, advising clients in various disciplines including securities litigation and bankruptcy.

Riverol, who received the local award, is CFO for the city of South Miami. During his three-year tenure with the city, Riverol has worked with the IRS and SEC to resolve preexisting issues on the city's comprehensive annual financial report (CAFR). The latest CAFR had zero findings for the first time in the city's recent history. ❖

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THE LAST WORD

I was born in Havana, Cuba, and it was a great childhood. I still have vivid memories of those times. Those were probably some of the happiest days of my life because our family was together prior to the revolution.

My father, who was in the wholesale meat business, was also a minority owner in a bank. My brother also worked at the bank and had run-ins with some of the Castro officials. In order to protect my brother, my father got him off the island in October 1960, to the United States. Right after they closed down the Catholic schools in '61, my parents saw a turn for the worse with the revolution—not that they ever supported it; they were against it from day one. At that time they finally decided they would get me off the island. I left in '62, when I was 9 years of age.

I still remember, vividly, my mom's words: "You'll only be out for 30 days. Castro has no staying power. It'll just be a short visit to your brother in Tampa, Florida, and you'll soon be back." And I honestly believed that until I finally arrived in the States. I started thinking about the situation, and it was really rough because I said to myself, "I'm 9 years old and I might not even see my parents again, let alone go back to the island." I was in the U.S. by myself for about five years, without speaking the language, and I lived in a Catholic boarding school until about the age of 14, when my parents were able to leave the island.

I had played baseball at the boarding school, and I later went to a high school in Tampa where we won two state championships, which was a real thrill. Once I graduated from high school, I attended junior college on a baseball scholarship. I then played two years of college baseball at Florida International University. I was a pitcher, and by my senior year I knew that my baseball career was over. The fastball just didn't seem to get to home plate as quickly as it used to. It was much tougher to pitch at that level and blow it by a hitter. While I was at Florida International University, I was lucky enough to have some great accounting instructors.

I answered an ad to my current firm back when it was known as Caplan, Morrison, Brown and Co. The position was for a mid-level accountant, but the starting salary was $12,500. I said, "I'm not going there unless you pay me $13,500." After negotiating for almost a month, I officially joined the firm in September of 1977. Through the years, I became very close to Albert Morrison Jr., the founder of the firm, who oversaw the larger accounts. Looking back on our relationship and how he mentored me, it's almost like he was grooming me to take over the firm.

My accounting career has been a great ride. It's something I still look forward to on a day-to-day basis. I enjoy what I'm doing, and I'm passionate about it. I don't know what I would have done if I hadn't been a CPA. I guess maybe if I'd been as good at baseball as accounting, maybe I could have pitched in the major leagues for a while. But I wasn't, and I was born with the gift of math, which has always helped out.

It's such a great profession. Anyone who studies accounting in college—they're just opening themselves up to such opportunities. Whether it's private, working for a corporation, or public accounting, there are so many avenues. Growing MBAF has just been a wild ride and a wild experience. It's something that I wish I could write a book on because it's just been so challenging and it still is on a daily basis.

I think that the best advice to young accountants who want to run a firm one day is to obtain the training. Get a mentor. Really develop your skills. Try to learn as much as you can so when the opportunity presents itself, you're ready to take it on. You've got to be able to put in the hard work and develop yourself technically to gain the confidence of your clients. But you also have to build your listening skills, so that you not only know how to present your ideas and strategies to clients and colleagues, but how you listen to their concerns and understand their needs. Succeeding in this business is not just about solid expertise—it's about gaining great judgment, strong insight, and the real confidence of clients through your listening abilities.

—As told to Chris Baysden, cbaysden@aicpa.org, a JofA *senior editor.*

Antonio "Tony" Argiz, CPA/ABV/CFF
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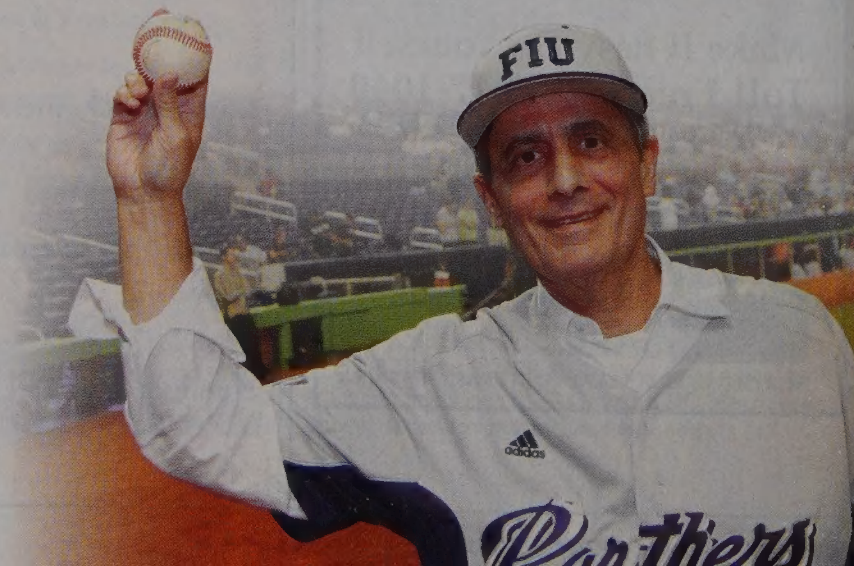

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